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Product Liability Exposure:

*How to Manage and Mitigate
the Risks in Today's Global Market*

Appendices A, B, and C—containing a complete summary of each state's product liability statutes, a summary of the joint and several liability statutes or common law application, and a state-by-state guide of the statute of limitations applicable to product liability actions—is available for download on the NAED Website at www.naed.org.

2008 WHITEPAPER

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<u>I. Introduction</u>	<u>2</u>
A. Items Addressed by the White Paper	3
B. Globalization of the Channel	4
C. Current State of the Electrical Distribution Channel	5
<u>II. Status of the Private Label Market</u>	<u>6</u>
A. Growth of the Private Label Industry	7
B. Sustaining Brand Equity	8
C. Size of the Private Label Market	9
<u>III. The Rise in Electrical Product Liability Exposures</u>	<u>10</u>
A. Frequency and Severity of Electrical Product Defects & Malfunctions	11
B. The Basis of Exposure for Electrical Distributors on Product Liability Claims and Lawsuits	12
C. Strict Product Liability and Negligence	14
D. Warranties Involved in Product Liability Actions	15
<u>IV. How Lawyers Look at the Development of a Product Liability</u>	<u>16</u>
A. Knowledge of Prior Incidents or Malfunctions	18
B. Elements of Damages	18
C. Venue of the Case	19
D. Defenses to a Product Liability Suit	20
<u>V. Product Liability in Foreign Countries</u>	<u>21</u>
A. Europe	22
B. Asia	22
C. The U.S. vs. Foreign Markets	22
<u>VI. What is Causing the Increase in Claims Against Electrical Distributors?</u>	<u>23</u>
A. Joint & Several Liability	24
B. The Role of Counterfeit Electrical Products	25
C. Trademarks and Intellectual Property	28
<u>VII. How to Protect Yourself from Counterfeit Electrical Products</u>	<u>29</u>
A. Proactive Measures	30
B. Specific Counterfeit Indications	31
C. Recall of Electrical Components	32
D. Costs & Requirements	34
<u>VIII. Insurance Issues</u>	<u>36</u>
A. Commercial General Liability Policy	37
B. The Certificate of Liability Insurance	38
C. Cancellation of Insurance by the Manufacturer	39
D. Best Practices	40
E. Vendors' Endorsements	41
<u>IX. Observations, Conclusions and Recommendations</u>	<u>43</u>
A. Managing Product Liability	44
B. Top 10 Recommendations	44
C. The Educated and Prepared Electrical Distributor	45



Introduction

PRODUCT LIABILITY EXPOSURE:

*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER ONE HIGHLIGHTS:

- >> Items Addressed by White Paper
- >> Globalization of the Channel
- >> Current State of ED Channel

The recent confluence of competitive pricing, the need to enhance corporate profits, the advent of cheaper labor and products flooding the channel from offshore manufacturers, and a precipitous decline in product brand loyalty have created a new reality of business and risk exposures in the electrical distribution channel.

This “new world” has also ushered in the potential of electrical product liability claims and lawsuits, and recalls in which the distributor is named as a direct party. In the past, the manufacturers were the ones responding to these suits. If a distributor was named, they were afforded protection through the contract with or by the insurance coverages of the manufacturer. However, the world and exposures of distributors have changed. Add to this the prospect of enforcement actions by the federal and state government agencies due to malfunctions and defects caused by substandard component parts, a failure to follow design specifications, and a lack of adequate quality assurance controls, and the frequency and severity of liabilities become newly defined.

Further, the combined trends of globalization, private labeling, the use of offshore manufacturers, trademark infringements, and a relative flattening of demand by consumers and commercial buyers are turning these developments and trends into facts and consequences that cannot be ignored but that can—and must—be proactively prepared for and managed before a loss has occurred. The realities and consequences are more than just the exposures and potential legal liabilities coming from the increases in private labeling. They extend beyond the traditional marketplace exposures electrical distributors have been dealing with for decades; they are creating innovative realities of which every electrical distributor must be aware. Moreover, these new consequences mandate revising business plans and regularly appraising the adequacy of the distributor’s contractual and insurance protections to fully secure the reputation, brand, and goodwill of the enterprise.

Today’s electrical distributors must, however, be more knowledgeable, nimble, flexible, and able to adapt to ever-changing market conditions and consumer demands. Differentiation, specialization, secured relationships, and a recommitment to service and responsiveness are all core components of the business plan needed to sustain profitability in the global marketplace.

A. Items Addressed by the White Paper

This white paper, sponsored by the NAED Education & Research Foundation and its Channel Advantage Partnership, has several purposes:

1. *To survey the electrical distribution channel and surrounding landscape to provide a definitive and reliable report on the current state of the various issues and consequences*
2. *To analyze the impact of risk exposure drivers and their consequences*
3. *To examine the prevalence of product liability exposures, joint and several liability, and how lawyers representing injured parties are reacting by filing claims and lawsuits against distributors*
4. *To review applicable insurance policies, including vendors’ endorsements and additional insured endorsements*
5. *To provide resources and recommended solutions for electrical wholesalers and distributors to mitigate and manage the risks of doing business in a global economy*

As part of this effort, we examine the circumstances by which an electrical wholesaler can be made party to a product liability claim, lawsuit, settlement, or judgment. The concept is

to ensure that electrical distributors and their customers understand and appreciate the current state of affairs and have the tools in hand to provide further protection to their reputations and relationships.

B. Globalization of the Channel

Corporate America has responded to the calls of their balance sheets, stockholders, and consumers to cut costs and increase efficiencies. At the same time, it has also enhanced research and development investments to bring new and innovative products, solutions, and service offerings to the free enterprise marketplace.

As Thomas Friedman articulates well in his book, *The World Is Flat: A Brief History of the Twenty-first Century*¹, “flattening of the world means we are now connecting all the knowledge centers on the planet together into a single global network which...could usher in an amazing era of prosperity and innovation.” The consequences of this have given birth not only to a new industry of researchers, designers, manufacturers, suppliers, shippers, consigners, and others in the distribution chain, but also to new international markets, communities, and previously unknown issues.

For example, in its April 7, 2007, editorial, *The Economist* noted that Indian and Chinese manufacturing facilities are becoming more competitive than their Western counterparts. They are taking a course similar to that taken by Japan in the 1980s and South Korea in the 1990s, when Western automobile and consumer electronic manufacturers had to rethink their business plans, budgets, marketing, and sales activities.

Further, offshore manufacturers are unencumbered by the accumulated legacies of their rivals. They are also more agile, and do not have similar corporate governance or reporting requirements in place. This allows them to be more price competitive and more flexible in adapting to changing market conditions.

“*flattening of the world means we are now connecting all the knowledge centers on the planet together into a single global network which...could usher in an amazing era of prosperity and innovation.*”

The future for offshore manufacturers is dependent on a number of factors including:

- >> who the manufacturer is and whether its strategy is long term or one to maximize the current potential and then depart for other endeavors;
- >> quality assurance, inspections, regulations, and enforcement not as strong in foreign countries as in the United States;
- >> incumbent or domestic manufacturers operating on a principle of value for money, which depends on price, service, brand reputation, and quality;
- >> the skill level of domestic manufacturing employees and electrical wholesalers who sell the products and component parts being more sophisticated than what one might find offshore; and
- >> electrical consumers and distributors seeking improvement in customer relationship management (CRM), enhancing brand quality, providing new and innovative services, and standing behind the products they sell.

These factors are more prevalent and developed in North America than in third-world countries. Nevertheless, globalization is flourishing based on the elimination of many barriers previously stopping cross-border commerce.

Sales through electrical product and circuit breaker brokers, via e-commerce over the Internet, and by telephone have a tendency to allow wholesalers and other customers to be less sensitive to brand-name products, to where the products were manufactured or by whom, and to obtaining a product at the least possible price—irrespective of the quality and certification assurances.

The pharmaceutical industry observed the same realities over the course of the last two decades, as traditional manufacturers of prescription drugs saw an advent of generic



market at a glance



Q1&2 2006: **↑13%**
ELECTRICAL WHOLESALE INDUSTRY



2006: **↑7%**
INDUSTRY SALES



2006: **↑11%**
NONRESIDENTIAL SALES



Q4 2006: **↓12%**
RESIDENTIAL SALES



2011: **↑5%**
ANTICIPATED GROWTH CYCLE

“...while 2006 was profitable overall for the electrical industry, the growth curve had begun decelerating by the fourth quarter, while industry sales advanced nearly 7%.”

ones having similar propensities as the brand names at a much cheaper cost. Due to the aging of the American population and the high cost of prescriptions for senior citizens, generic medication almost seemed a natural and cheaper course for those on fixed incomes to remain well or return to health after an illness or surgery.

C. Current State of the Electrical Distribution Channel

Herm Isenstein's recent article *"2007 Economic Update"* indicated that the same is true in the electrical wholesale industry. The article's survey revealed that sales have not been as positive as they were 12 months ago. For example, forecast data from DISC Corporation in Orange, CT, uncovered that the first half of 2006 was a peak growth period in the electrical wholesaling industry's business cycle, up 13% compared with the first half of 2005¹. The survey also noted that while 2006 was profitable overall for the electrical industry, the growth curve had begun decelerating by the fourth quarter, while industry sales advanced nearly 7%.

The nonresidential sales market grew at a rate of 11% in 2006, while the residential market softened with a loss of more than 12% in the last quarter of the same year. Key economic indicators suggest that the strong profits experienced in 2005 and 2006¹ have slowed substantially. In addition, the recent increase of the mortgage interest rate by the Federal Reserve and a commensurate slowing of new housing construction in virtually all U.S. sectors indicate that the pressure on profitability and sales will become even greater. In fact, Isenstein concluded, according to the DISC forecast, a growth cycle of up to 5% will not be seen until 2011. Thus, single-digit growth across major segments of the electrical wholesale channel is anticipated.

These factors are merely additional circumstances electrical distributors will be experiencing when looking for solutions to maximize sales and profits. Against the foregoing background, we now are able to evaluate the "alternating" current state of the channel to determine the respective business, legal, and risk exposures distributors face by buying and selling private label, counterfeit, or other products and component parts from offshore manufacturers. These risks are even more pronounced when distributors deal with even less than reputable onshore manufacturers who are unable or unwilling to stand behind the quality of their products and their contractual relationships.



Status of the Private Label Market

PRODUCT LIABILITY EXPOSURE:

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CHAPTER TWO HIGHLIGHTS:

- >> Growth of the Private Label Industry
- >> Sustaining Brand Equity
- >> Size of the Private Label Market

During the course of our research and work pertaining to the private labeling of products sold, we interviewed eight electrical distributors, 10 manufacturers, six channel thought leaders and experts, and six insurance companies, agents, and brokers. We focused these interviews on the current status and developing trends in the electrical wholesale industry specific to the private label issue.

Here are *appropriate definitions* and concepts readers will want to be aware of:

PRIVATE LABELING is defined as products manufactured or provided by one company under another company's brand. Private label products are typically those manufactured or provided by one company for offer under another company's brand.

PRIVATE BRANDING occurs when a large distribution channel member buys from a manufacturer in bulk and places its own name on the product. This strategy is usually used when a retailer or wholesaler undertakes high levels of product volume. The business seeks to have more freedom and flexibility in pricing, to have more control over the product attributes and quality, to eliminate manufacturers' commercial costs, and to sell at a lower price or establish higher margins of profitability.

Traditionally, electrical products or component parts under private labels are often positioned as lower-cost alternatives to other established, incumbent, or recognized brands. These products and parts offered under private label brands can also be positioned as "premium brands" to compete with existing name brands. Historically, private labels had been viewed low in both price and quality. In recent years, however, companies have started using private labels to also market higher-quality items. The growth of the private label industry has also formalized in its own separate industry. For example, the Private Label Manufacturers Association (www.plma.com) has organized members around the world and conducts annual conventions and trade shows. A recent survey of the power of private labeling (conducted by the AC Nielsen Company) concluded that the growth of the private label market is expanding annually and has "*unlimited potential*."⁴

The importance of sustaining brand equity in the electrical wholesale marketplace brings the discussion of private labeling full circle. Our interviews and research confirmed that electrical manufacturers will regularly contract with a Chinese factory to source products. In addition, it is no longer an anomaly for electrical distributors and even independent manufacturer's representatives to also establish their own private labels⁵.

Some distributors have been private labeling products for many years. For instance, the Fastenal Company of Winona, Minn., currently sources 15% of its products directly from Asia and is evaluating opportunities to directly source up to 20% more of its existing product line⁶.

In our research, we were asked to ascertain from channel partners the size of the private label market, and to what extent manufacturers

and distributors were undertaking private labeling or branding activities. The survey responses we received varied greatly. While some in the industry were pleased to provide additional information in respect to their activities, others would speak only on the condition of anonymity. It also appears that the timing of our survey may have coincided with some of the recent articles in the trade

A recent survey of the power of private labeling concluded that the growth of the private label market is expanding annually and has “unlimited potential.”

Conducted by the AC Nielsen Company

press pertaining to recalls of tires, toothpaste, food, dog food, and lead-based paint toys, all manufactured in China. This made some of the channel members reluctant to confirm or deny the extent to which they were sourcing products from overseas.

We also witnessed that the public stakes in the private label arena are very high. After the August 2007 recalls of lead-tainted toys by Mattel, Inc., the owner of the Chinese manufacturing company where they were made reportedly committed suicide. While it is unclear whether the suicide was linked to the recall, an article in the *Wall Street Journal* made an interesting point. The article reported that the incident will likely become a tragic symbol of the mounting pressure on plant managers and Chinese manufacturers to improve operations and maintain credibility in the wake of recent high-profile product recalls.⁷

Therefore, given this background, it is difficult to estimate the size of the electrical product private label market with a degree of certainty. However, our interviews and trade press articles suggest that the amount of private labeling is increasing. We were further advised that private labeling entities are preparing future business plans in which their activities in this respect are going to be increased even further.

Similarly, the survey conclusions performed by Adam J. Fein, Ph.D., and Pembroke Consulting, Inc., revealed that an average 43% of wholesale distributors currently market their own private label products from an overseas plant. By 2012, the report estimates that 81% of wholesale distributors will be sourcing overseas.⁸

This report examined wholesaler distributors generally, as opposed to just those in the electrical product industry. Thus, the findings further mirrored those in the NAED research study in that private label sourcing is happening in a wide range of countries, including China, India, Mexico, Canada, Korea, and Taiwan. This trend is expected to continue. Many industry and channel thought leaders expect China's low-cost labor to be sustainable for at least a generation, thus accounting for that country's growth as a competitive force. Chinese-manufactured exports are now estimated to exceed those of the United States, whereas American-manufactured exports more than doubled those coming from China in 2001 alone.⁹

The report further notes that consumer electronics and industrial goods are quickly replacing low-end products such as apparel in regard to the products and parts that are being exported from China. In 2005 alone, \$53.1 billion of electronics and electrical products were imported from China, representing just over one-fourth of the total U.S. imports of these product categories.¹⁰

 **private label rising**



2008: 43%
WHOLESALE DISTRIBUTORS
CURRENTLY SOURCE OVERSEAS

2012: 81%
OF WHOLESALE DISTRIBUTORS
WILL BE SOURCING OVERSEAS

Among private label suppliers, we discovered the following sources of electrical components and products:



private label sourcing

China: **38%**
Existing or
incumbent manufacturers: **26%**
Brokers: **23%**
Other countries: **7%**
India: **6%**

The distributors and manufacturers with whom we spoke in researching the issues addressed in this white paper noted that while private label products have an impact on sales, they also have a demonstrable impact on profitability. In fact, 38.2% of the distributors contacted believed private label products can provide 20% to 50% incremental margin opportunity. Among the highest electrical products sourced, our survey revealed that the following contained the highest number of private labels:



Electrical tape
Electrical connectors
Electrical fittings
Wiring devices
Circuit breakers
Recessed lighting

This list, regrettably, appears to mirror the nature of recalls made by the U.S. Consumer Products Safety Commission (CPSC) based upon electrical products being manufactured overseas.

To illustrate the sensitive nature of the subject, our research efforts showed that:



- when asked about private labeling, some in the industry were pleased to provide additional information in respect to their activities, while others would speak only on the condition of anonymity.
- it also appears our survey coincided with some of the recent articles in the trade press pertaining to recalls of tires, toothpaste, food, dog food, and lead-based paint toys, all manufactured in China. This made some of the channel members reluctant to confirm or deny the extent to which they were sourcing products from overseas.

Q & A

WHERE IS THE PRIVATE LABEL MARKET GOING?

The incremental growth of private labeling in the electrical products industry is no longer an anomaly, but rather an opportunity being exercised by an increasing number of electrical wholesalers and manufacturers.

Further, based upon current economic realities and competitive pricing, it is expected that the private label market will continue to increase.



The Rise in Electrical Product Liability Exposures

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CHAPTER THREE HIGHLIGHTS:

- >> Frequency and Severity of Electrical Product Defects and Malfunctions
- >> The Basis of Exposure for Electrical Wholesalers on Product Liability Claims and Lawsuits
- >> Strict Product Liability and Negligence
- >> Warranties Involved in Product Liability Articles

In today's increasingly litigious business climate, the ability to manage or mitigate as many potential liability and other claims as possible is often the difference between financial success and failure. An annual survey conducted by the Tillinghast Towers-Perrin organization in 2006 concluded that tort costs in the United States currently amount to \$297 billion. This translates into a per capita "tort tax" of \$845 per person, equaling about 2.24% of the U.S. Gross Domestic Product.

In addition, The Pacific Research Institute released a report in 2007 examining the business interruption, downtime, lost profits, and other attendant circumstances of the current state of the tort environment. The results were also substantial, revealing that the total accounting cost of the tort system is actually \$865.4 billion, equivalent to \$9,827 for a family of four. In preparation of this white paper, we interviewed numerous thought leaders, channel experts, insurance agents and brokers, attorneys, and others engaged in the liabilities of electrical wholesalers.

A. The Frequency and Severity of Electrical Product Defects & Malfunctions

The consequences of being injured or damaged as a result of a defective electrical product or component part can often be more catastrophic than other types of consumer products. Electrocution, death, fires, business interruption, and property damages are merely a few of the types of damages reaching the hundreds of thousands, if not millions, of dollars depending upon the nature and extent of the injury or property damages sustained.

In fact, the CPSC¹¹ indicates that there were 440 total accidental electrocutions in the United States in 1999, 170 of which were related to consumer products. Twenty-nine were a result of household wiring, 29 related to small appliances, 22 to large appliances, 15 to power tools, 13 related to ladders, 12 to garden or farm equipment, and nine to lighting equipment.

However, the latest statistics from the National Fire Protection Association (NFPA) noted that an annual average of one out of 12 reported home fires and one out of 14 associated civilian

extent of defects & malfunctions

440

TOTAL ACCIDENTAL ELECTROCUTIONS

170

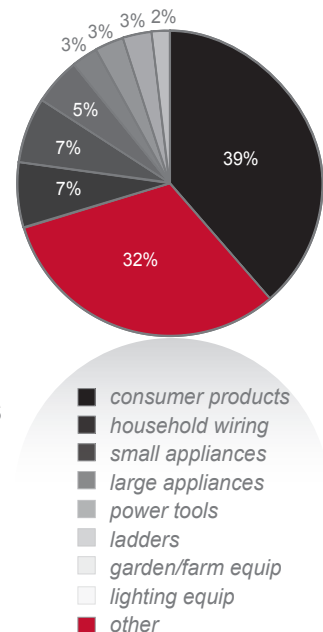
WERE CONSUMER-ELECTRONIC RELATED

1 out of 12

REPORTED HOME FIRES DUE TO ELECTRICAL MALFUNCTIONS

1 out of 14

ASSOCIATED CIVILIAN DEATHS ARE DUE TO ELECTRICAL MALFUNCTIONS



deaths are due to electrical malfunctions.¹² An estimated 32,000 home structure fires per year were associated with electrical distribution equipment between the years 1999 and 2002. These fires resulted in 220 civilian deaths, 950 civilian injuries, and \$674 million in direct property damage per year.¹³ Further,

- *wiring, switches, and receptacles were the equipment involved in ignition in 45% of the reported home structure fires involving electrical distribution equipment;*
- *extension cord fires outnumbered fires beginning with attached or unattached power cords by more than two to one; and*
- *electrocution is now the fifth leading cause of work-related deaths in the United States, with over 50% of the total occurring in the construction industry.*¹⁴

B. The Basis of Exposure for Electrical Distributors on Product Liability Claims and Lawsuits

Unique market forces are currently defining the global economy and the reality that the United States has increased the importation of manufactured products from developing and third-world countries in greater numbers each year. These forces bring us now to the consequences of electrical products and component parts that expose the distributor to legal liabilities for damages and injuries sustained by third persons, customers, and commercial entities.

During the course of our research, it was patently evident that more and more manufactured products are being imported into the United States than ever before. Even American flags fall into this category. In 2006, the value of U.S. flags manufactured and exported by U.S. companies amounted to \$1.7 million, compared to \$5.3 million of American flags imported from overseas. As one might expect, the top maker of imported U.S. flags is China.¹⁵

Unfortunately, many distributors do not fully understand or appreciate the consequences of their prospective involvement in product liability litigation when an electrical product

or component part has malfunctioned or failed to form as expected. In summary, the electrical distributor can be sued and held liable for a number of circumstances. These include:

- **bodily injuries and property damage losses caused by the product;**
- **instructions for use, warnings, and labels;**
- **the product packaging; and**
- **other circumstances, even pertaining to the design of the product**

In most of these circumstances, the distributor had no role or responsibility.

Most of the time, the manufacturer is the first focus of a claim or lawsuit based upon the malfunctioning or defect of an electrical product and will stand behind its products. However, an electrical distributor can be propelled to stand and then walk in the shoes of the manufacturer when the jurisdiction of the U.S. courts is unable to reach the manufacturer. This can also happen

when the supplier has inadequate insurance protection or its insurance protection has been exhausted, and where its balance sheet cannot support the defense costs, potential settlement, or judgment accrued in a product liability claim or lawsuit.

In addition, the channel is filled with electrical distributors who perform extra value-added services, installation, or repair work for their customers. Separate and apart from the liabilities faced by or from a manufacturer, these “value-added” activities can open the door for additional exposures to the distributor. Each of the “services” listed below can subject the distributor to additional corporate exposure:

- **repackaging or relabeling of products;**
- **modification of instructions for warranties;**
- **repackaging the product under the wholesaler’s brand; and**
- **recommending a product nonconforming with the job to be performed, or the job specifications.**

“In 2006, the value of U.S. flags manufactured and exported by U.S. companies amounted to \$1.7 million, compared to \$5.3 million of American flags imported from overseas. As one might expect, the top maker of imported U.S. flags is China.”

This is not to say that electrical distributors should not perform value-added services, training, and other activities for their customers. Frankly, these very services are benefits distinguishing electrical distributors from one another and providing their incremental value in the channel and distribution network. However, in the event such activities are undertaken, the electrical distributor must appreciate the prospect of additional exposures it faces, and take appropriate measures and precautions to ensure that these activities are properly insured or otherwise adequately covered.

In addition to the “value-added” services performed, an electrical distributor can also incur legal liability where it has or should have knowledge of a defective or unreasonably dangerous condition of a product prior to its sale, and where the distributor did nothing to remove the product from its shelves or provide proper warning or notices both up and down the stream of commerce.

Further, there is no getting away from the fact pursuant to the U.S. legal system that anyone in the stream of commerce involved in bringing a particular product from the design phase all the way through to the purchase point can be part of a lawsuit. To this extent, at a minimum defense costs will be incurred in order to extract the party from litigation.

Where manufacturers are not able to be brought into court, the electrical distributor will stand in their shoes in respect to the claims of the injured party. The distributor will always have the opportunity to bring a manufacturer into the litigation or pursue a claim for contribution and indemnification (a claim pursuant to common law or contract where the distributor can effect its rights to have the manufacturer “contribute” its allocable share of responsibility, related injuries, and losses and/or fully indemnify the wholesaler to make it whole pursuant to the contract for the liability assumed of the manufacturer).

So what exactly is product liability?

➤ According to Black’s Law Dictionary, “product liability” refers to the legal liability of manufacturers and sellers to compensate buyers, users, and even bystanders for damages or injuries suffered because of defects in goods purchased. It is a tort that makes a manufacturer liable if its product has a defective condition making it unreasonably dangerous to the user or consumer.¹⁶

The ultimate responsibility for injury or damage in a product liability generally rests with the manufacturer. However, liability can be imposed upon a retailer, a wholesaler or middleman, a bailor or lessor, and infrequently a party wholly outside the manufacturing and distribution process, such as a certifier.

- In a strict liability claim, the plaintiff does not have to prove the manufacturer was negligent—only that the product was defective (unsafe if used as intended) or unreasonably dangerous (likely to cause harm).
- To collect damages, the plaintiff must show that:
- the product was defective when it left the control of the manufacturer, wholesaler, or direct seller; if the wholesaler altered the product, the manufacturer would not be liable; if the seller altered the product, the manufacturer and wholesaler would not be liable; and
 - the product caused medical injury or death, either directly (e.g., a circuit breaker exploded), or indirectly (e.g., a GFCI failed to trip, causing fire in a home or business).

Unlike negligence claims, the plaintiff’s conduct is not a defense against a strict liability claim because the product is deemed inherently unsafe. Under the state statutes, claims most commonly associated with product liability include the concept of negligence, strict liability, and breach of warranty, and the prospect of various other consumer protection claims. A 50-state listing of product liability laws and defenses is available as a supplementary document on the NAED website at www.naed.org. Click on the Foundation/Completed Research link.


The concept of “negligence” is best defined as:

- *the omission to do something that a reasonable person, guided by those ordinary considerations that ordinarily regulate human affairs, would do; or*
- *the doing of something that a reasonable and prudent person would not do.*


Generally, it is defined as conduct that falls below the standard established by law for the protection of others against unreasonable risk of harm and a departure from the conduct acceptable of a reasonably prudent person under like circumstances.¹⁷

C. Strict Product Liability and Negligence

The most common product liability claims fall into one or more of the following causes of action:

- 
- A design defect
 - A manufacturing defect
 - A failure to warn or provide adequate instructions

These claims will succeed even when products were used incorrectly by the consumer, so long as the incorrect use was foreseeable by the manufacturer or other parties in the supply chain. By contrast, the basic negligence claim requires the injured party to prove the following:

- 
- A duty owed by the party being sued
 - A breach of that duty
 - The sustaining of an injury or damages
 - Demonstration the breach of duty proximately caused or was responsible for the injury or damages sustained

Generally, product liability claims are not based on negligence, but rather on claims of strict liability.

Pursuant to this theory, a manufacturer, a distributor, and others in the supply chain can be held liable regardless of whether they acted negligently. Rather, the state legislators and laws have shifted the risk of loss to those who are involved in bringing the product to market since the injured consumer might have a more difficult time to prove what a manufacturer did or did not do in the design, manufacturing, marketing, or sales process. Further, and under the concept of strict liability, the risk and cost of a product defect or malfunction should be borne by the party in the distribution network of bringing the product to the consumer for sale.

This is based on the presumption that because manufacturers have greater insurance, financial resources, and ability to set the sales price for the product, they are better able to absorb these risks. Under the theory of strict liability, the focus is shifted to the product itself. Liability will attach if the product is defective, even if the manufacturer was not negligent in making the product defective. In operation, product liability suits also allow the injured party or the defendants the right to a jury trial under the seventh amendment to the U.S. Constitution, unless they choose to waive that right. Therefore, the result of establishing liability and the nature and extent of any damages to be awarded will be left to the peers residing in the venue of one or both of the parties to the litigation.

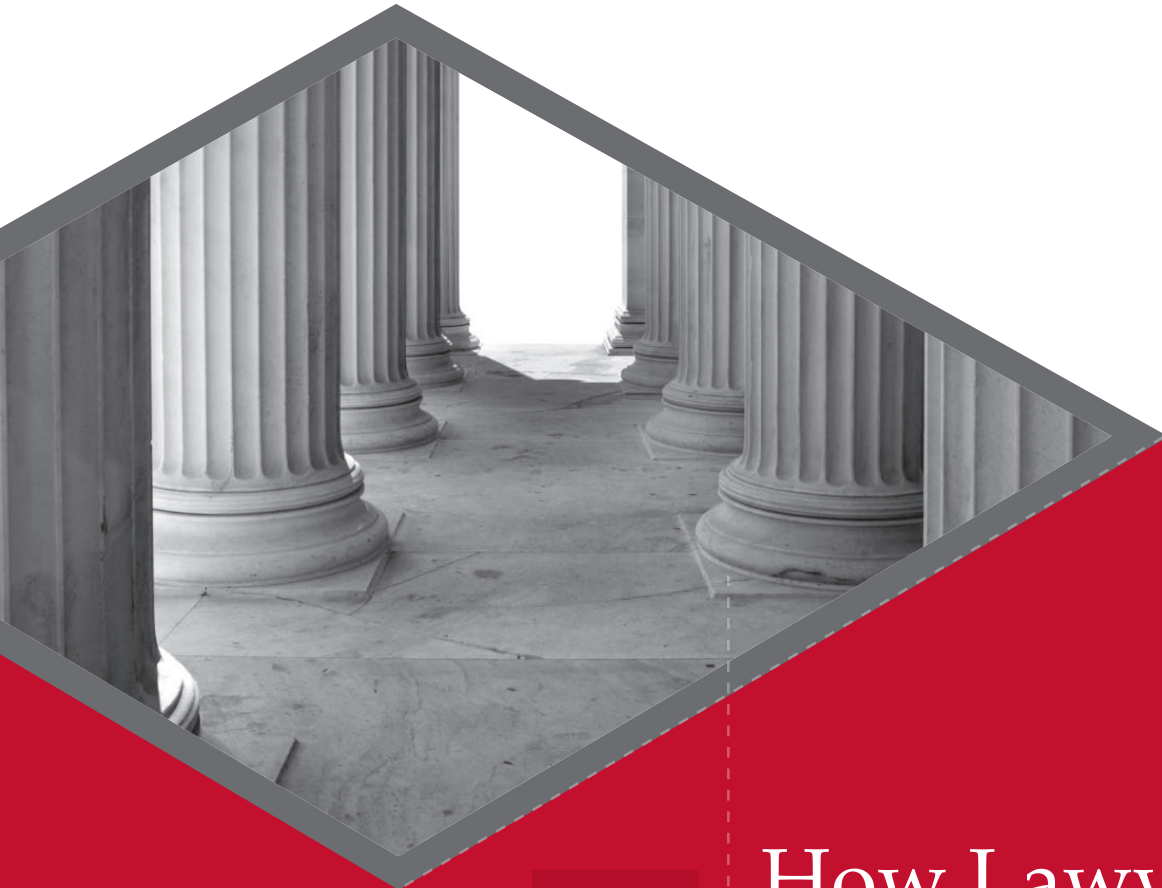
D. Warranties Involved in Product Liability Actions

“Warranties” can also enter into the product liability claim or lawsuits. These are statements by manufacturers, distributors, or sellers concerning the respective traits or operative properties of a product.

Whereas the focus is on the manufacturer’s conduct in negligence claims, and on the product in strict liability claims, warranty claims focus on how these issues relate to a commercial transaction.

They also require a direct connection or what is known as “privity” between the injured party/buyer and the manufacturer or distributor/seller. In other words, the injured party must have a direct commercial connection with the party being sued on a breach of warranty claim. Those claims will then usually be focused upon one of the following three elements:

- **Breach of an express warranty—statements directly made or “expressed” by the manufacturer, distributor, or seller pertaining to the product;**
- **Breach of an implied warranty of merchantability—expectations common to all products and “implied” either by the custom and practice of the industry or the knowledge of sophisticated purchasers in commercial transactions, or understood by reasonably prudent people; and**
- **Breach of an implied warranty of fitness for a particular purpose—it is reasonably understood that the product is suited for use in specific situations (e.g., a snow shovel is manufactured and sold for the purpose of shoveling snow).**



How Lawyers Look at the Development of a Product Liability Claim

PRODUCT LIABILITY EXPOSURE:

*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER FOUR HIGHLIGHTS:

- >> Knowledge of Prior Incidents or Malfunctions
- >> Elements of Damages
- >> Venue of the Case
- >> Defenses to a Product Liability Suit

In speaking with numerous plaintiffs' counsel representing parties injured by products, the bases of liability they seek to establish will fall into a variety of legal theories in the product liability context. While the applicability of the various theories of recovery depend upon the facts

of the case and laws of the jurisdiction, **counsel will examine the interests and rights of their clients and review the prospect of the following causes of action¹⁸:**

STEP
1

- Strict tort liability (as detailed above)
- Negligence or wanton misconduct
- Design
- Manufacture/assembly
- Quality control (i.e., inspection and/or testing)
- Packaging/shipment
- Marketing or selling a dangerous product
- Failure to warn
- Instructions for use
- Duties arising from a contract or bill of sale
- Duty arising from a voluntary undertaking
- Negligent entrustment
- Violation of state or federal statutes or regulation or municipal ordinances
- Violation of an industry code or standard
- Breach of warranty under the uniform commercial code
- Express warranties
- Implied warranties for merchantability or particular purpose
- Breach of contract
- Misrepresentation or deceit
- Fraud
- Nuisance
- Trespass
- Bodily injury
- The impact of statutes that may create independent causes of action

STEP
2

To ensure that a valid recovery can be obtained and an awardable verdict and judgment paid, **counsel will seek to involve any or all of the respective parties in the stream of**

bringing the product to the marketplace.

This will include the identification of a variety of defendants including the:

- designer of the component or finished product;
- provider of the design specifications;
- supplier of raw materials;
- manufacturer of the basic material, component part, or finished product;
- assembler of the component part or finished product;
- distributor, wholesaler, retailer, or other seller of the component part or finished product;
- party responsible for testing and/or inspection;
- party responsible for warnings and/or instructions for use;
- author of advertising and/or promotional literature;
- party responsible for certification of quality; and
- party responsible for maintenance and repair.

During the course of their prelawsuit investigation or in the final discovery process, **attorneys will seek to ascertain whether the defendants to the claim undertook any changes, repairs, alterations, modifications, or repackaging of the product at the time it was in their care, custody, or control.** They will then examine the specific design criteria or actual design of the model line, the choice of materials used in the manufacturing and assembly process, and the manufacturing and assembly procedures. Quality control procedures including testing standards and methods of examinations, as well as the experience of specific individuals undertaking the quality assurance activities, are also subject to investigation and discovery.

STEP 3

In addition, lawyers will also construe the instructions, manuals, guidelines, recommended maintenance, warnings, and other advertisements or representations provided to the consumer. These include written warranties, advertising, promotional literature, product inserts, assembly, or use of product instructions, maintenance manuals, or warnings. Counsel will examine the CPSC Website to ascertain whether a recall of a product has been affected and, if so, if the manufacturer and all others in the process have complied with the orders of the government or court.

A. Knowledge of Prior Incidents or Malfunctions

Another important aspect of counsel's analysis to maximize the opportunity for their client's recovery is the **investigation or discovery into whether the defendants knew or should have known of prior complaints of product malfunctions or defects.**

It is well settled that if a manufacturer, distributor, or others knew of such problems and failed to take remedial action, counsel will be able to argue that they are guilty of wanton, willful, and malicious conduct with a reckless disregard for the interests of the consumer specifically, and the buying public in general. *They will therefore make a demand for punitive damages to be awarded over and above compensatory damages to "punish" the defendants for failing to consider the known consequences of their product.*

compensatory damages are awarded to recompense or make the injured party whole, whether in the form of bodily injuries sustained or property damages incurred.¹⁹

Another component of damages awardable to those injured by product defects or malfunctions is referred to as "noneconomic damages." These are in addition to the quantifiable and verifiable property damage losses, medical bills, and other documented losses for physical therapy treatments, doctor visits, and wage losses. They include the pain and suffering an injured party experienced from the time of the incident through the period of recuperation and healing, if occurred. If the nature and extent of injuries are unresolved or are permanent in nature, the jury will be allowed to project the monetary value of pain and suffering into the future.

STEP 4

B. Elements of Damages

Once the jury or court has determined that the product was defective and/or the injuries, damages, and losses sustained by the plaintiff were proximately caused by the defendants, strict liability will be imposed and the matter will then be set for the awarding of damages. It is important for the electrical wholesaler to understand the types of damages awardable in a product liability law suit. Traditionally,

The U.S. legal system does not maintain definable parameters of damages awarded for these types of claims.²⁰ They are usually left to the jury's or judge's discretion with regard to the nature and extent of injuries or losses sustained by the injured party. The amount of damages awarded can also vary based upon whether the claim arises and/or the lawsuit has been filed in a state or a federal court, or with respect to the jurisdiction or state in which the matter is pending.

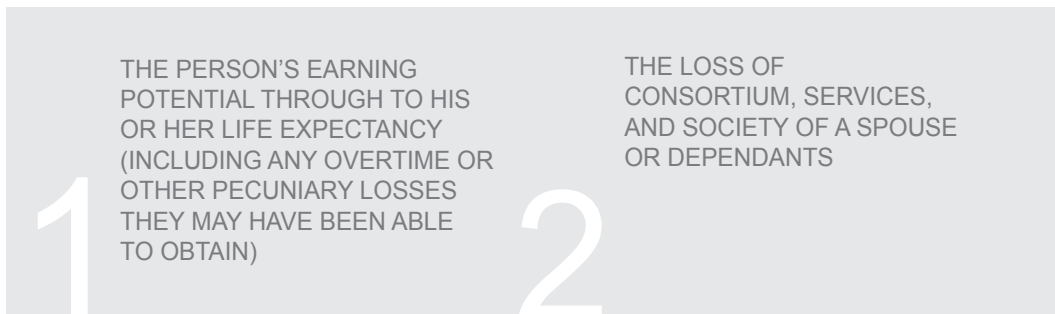
STEP 5

Thus, the prospective damages are substantial for an electrical distributor standing in the shoes of a manufacturer who is not subject to U.S. laws or jurisdiction, who has inadequate insurance protection, or who may have gone out of business. In summary, damages fall into a variety of categories, including:

“It is important for the electrical distributor to understand the types of damages awardable in a product liability law suit. Traditionally, compensatory damages are awarded to recompense or make the injured party whole, whether in the form of bodily injuries sustained or property damages incurred.”

- the amount of medical bills and other verifiable/documental losses;
- physical therapy treatments;
- loss of earning capacity;
- disfigurement;
- pain and suffering (noneconomic damages), which may be limited by various state statutes;
- physical handicaps;
- mental anxiety;
- psychic injury; and
- loss of consortium, and interest expenses assessed both for the time prior to the judgment and after the judgment.

Where a death has occurred as a result of a product malfunction or defect, damages can be awarded based upon two things:



In property damage losses caused by the product, the plaintiffs can be awarded damages for the diminished value to the property, repair or remediation of the property, the actual cash value of the property damaged, and any loss of use sustained. Economic losses can also be awarded based upon lost profits, lost opportunities, and damage to reputation.

C. Venue of the Case

Attorneys will also examine the appropriate venue or court within which to bring the litigation. This will determine the location of where the suit is commenced, and the question of which court or courts of those possessing adequate personal and subject matter jurisdiction may hear the suit in question. This will usually be determined by where the action arose or where the parties reside or have their principle place of business, or where their business is conducted.²¹



D. Defenses to a Product Liability Suit

While the applicability of any defense is dependant upon the facts and circumstances of a particular case and the law of the jurisdiction in which the suit is brought, the available defenses to a product liability action include demonstrating the following:



- The product involved was not manufactured or sold by the defendants.
- It is a counterfeit product improperly bearing the mark of the manufacturer.
- The product is not defective or unsafe or unsuitable for its intended purpose by showing the defendants exercised due care, met or exceeded industry custom, met or exceeded applicable statutes and regulations, gave adequate warnings, or provided options.
- The product itself is unavoidably unsafe but still met or exceeded the state of the art at the time.
- The danger of the product was open and obvious.
- The plaintiff or injured party understood the danger but, nevertheless, assumed the risk and utilized the product in a manner that was unforeseeable, unintended, or in derogation of his or her understanding.
- The condition of the product had been substantially changed at the time of the injury after having left the care, custody, and control of the defendants through other alteration, abuse, and wear and tear.
- The defect or malfunction in the product did not cause or produce the injury or claimed damages.
- The use was not reasonably foreseeable.
- A change in the condition of the product caused or produced the injuries or damages sustained.
- There was an intervening and superseding cause.
- The incident was unavoidable.
- There was compliance with applicable statutes, regulations, state-of-the-art industry, customs and standards, and due care.
- There was alteration/modification contributory or comparative “fault” (where applicable).
- The plaintiff failed to abide by other statutes, including the time limitation provisions in which a product liability claim must be brought or otherwise be barred, which also varies from state to state; unless a special circumstance is involved, the statute of limitations period begins to run from the date on which the occurrence took place that caused the injury or loss.

Appendix C, state-by-state guide of the statute of limitations applicable to product liability actions, is available as a supplementary document on the NAED website at www.naed.org. Click on the Foundation/Completed Research link.

Another limitation statute applicable in product liability actions is known as the “statute of repose.” These statutes are state specific and designed to limit the exposure of manufacturers, distributors, and sellers. They begin to run from a specified time or event regardless of whether a claim has accrued or an injury has occurred. Therefore, a statute of repose may actually bar a claim before it has taken place. These statutes focus on the age of the product and are based on what would be unfair to subject a manufacturer, distributor, or seller to product liability exposure following the passage of a substantial period of time, the wear and tear of the product, improvements to design in successive products, and other circumstances.

DEFINITION: “noneconomic damages”

These are in addition to the quantifiable and verifiable property damage losses, medical bills, and other documented losses for physical therapy treatments, doctor visits, and wage losses. They include the pain and suffering an injured party experienced from the time of the incident through the period of recuperation and healing, if occurred. If the nature and extent of injuries are unresolved or are permanent in nature, the jury will be allowed to project the monetary value of pain and suffering into the future.



Product Liability in Foreign Countries

PRODUCT LIABILITY EXPOSURE:

*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER FIVE HIGHLIGHTS:

- >> Europe
- >> Asia
- >> The US vs. Foreign Markets

A. Europe

While not as volatile as the U.S. product liability industry, the European Union and other countries have also experienced an increase in the amount of product liability litigation, especially for goods imported and then transferred between member states. The surge of manufactured goods from the Far East and China, some of them counterfeit and dangerous, highlighted concerns about the rights of end-user consumers and the position of importers/distributors who may have legal

liability to consumers. As a consequence, the European Union enacted a product liability directive in 1986, which was updated in 1999. The Consumer Product Act of 1987 established that where there are any damages caused by a defect in a product, every producer should be liable unless a defense applies.²²

The act also makes reference to the term “producer,” which is defined as any participant in the production process; the importer; any person placing his or her

name, trademark, or other distinguishing feature on the product; any person supplying a product whose producer cannot be identified; and the manufacturer. The European Union General Product Safety (GPS) directive (92/59/EEC) is focused on preventing unsafe products from reaching the market. Among various other actions, it obliges member states to ensure that producers place only “safe” products on the market; producers and distributors participate in product monitoring and product information initiatives; and national enforcement authorities are provided adequate powers to ensure compliance with these obligations.

It also encourages cooperation between the relevant regulatory authorities across all member states in the European Union and establishes a system for rapid information exchange known as “Rapex” between the member states and the European commission. The European Union product liability directive (85/374/EEC) is the vehicle by which legal rights are conferred upon consumers, allowing

them to sue producers of defective products that have caused injury or loss while both directives have been implemented by all European Union member states. Significant differences between how product safety and liability issues are resolved will vary from one jurisdiction to the next.

The differences between the U.S. and European legal systems as pertains to product liability matters can probably best be summarized by an example brought forward by the Dow Chemical Corporation, which estimates it spends \$1 on litigation costs for every \$71 in sales in the United States. By comparison, in Europe, litigation costs are \$1 for every \$7,000 in sales.²³

B. Asia

In the Asia-Pacific region, a recent study showed that there has been no large or widespread increase in current liability claims.²⁴ With many countries now going through a period of strong economic development, some legislators are now beginning to recognize the need to address consumer protection and the legal liability of manufacturers, distributors, and sellers in their respective regions.

Some countries like India, Singapore, and Hong Kong do not have a specific body of law dealing with product liability. Rather, consumer protection is dealt with in their general principles of common law, or statutory provisions are applicable to each state.

C. The U.S. vs. Foreign Markets

The European Commission undertook a study in 2003 to examine the practical impact of product liability issues in each of the member states in order to examine whether further reform was required. The study concluded that a growing litigation culture was present in the European Union.²⁵ Therefore, it appears as though American laws are further along in developing the risks and exposures under product liability claims and lawsuits than in other developed countries (and, most certainly, more than in third-world countries). This fact further explains why lawyers representing injured parties from defective or malfunctioning products will seek to bring their claims under U.S. laws and statutes, and against American distributors and wholesalers, rather than foreign manufacturers.

\$ United States
\$1 FOR EVERY
\$71 IN SALES
DOW CHEMICAL SPENDS
ON LITIGATION COSTS

€ Europe
\$1 FOR EVERY
\$7,000 IN SALES
AVERAGE LITIGATION COSTS



What is Causing the Increase in Claims Against U.S. Electrical Distributors?

PRODUCT LIABILITY EXPOSURE:

*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER SIX HIGHLIGHTS:

- >> Joint and Several Liability
- >> Role of Counterfeit Electrical Products
- >> Trademarks and Intellectual Property

In looking at the issues presented, we sought to understand exactly what *the drivers* are of the consequences in which electrical distributors will find themselves. Speaking with attorneys from across the country, we were able to confirm that they continue to focus on parties engaged in bringing an allegedly defective product to the marketplace that has injured or damaged a third party. **Under our legal system, a product liability action can be brought by any or all of the parties involved in the stream of commerce for those products.**

However, they further advised that where a foreign manufacturer may be involved in the chain, it is easier, cheaper, and more expeditious to merely file a lawsuit against the electrical distributor alone and/or others who might be in the United States. They will avoid going after foreign entities because of the cost involved in researching whether an

offshore manufacturer is subject to American laws, suing them in the country of their principle place of business, having to translate legal documents into the language of the country in which the manufacturer's business is located pursuant to the requirements of the Hague Convention (where that country is a signer to the Convention), engaging experts or other resources necessary to develop that case through discovery efforts, and, finally, trying it before a foreign jury or judge.

Rather, under the principles of joint and several liability,²⁶ the opportunity is to merely sue the domestic electrical distributor and bring that case to judgment or settlement. Thereafter, the distributor can seek its own redress against others pursuant to any contractual, indemnification, hold harmless, or other insurance endorsements available and collectible under the circumstances.

JOINT AND SEVERAL LIABILITY


One of the legal principles coming into play in product liability and negligence actions is a concept known as "joint and several liability." Essentially, this concept allows an injured third-party plaintiff to recover all damages from all of the responsible defendants (jointly) or any of the defendants individually (severally), regardless of their individual share of liability. Most states still have a joint and several liability statute, although tort reform efforts have limited the applicability of some and eliminated others.

The operation of the joint and several liability statutes allows the injured party to recover the entire amount of its damages from all of the defendants (jointly) or from any of the defendants individually regardless of their respective share of the liability (severally), as assessed by the jury or the judge. Usually, these allocations are made to the exception of the injured party.²⁷ A summary of the joint and several liability statutes or common law application is contained as Appendix B on the NAED website at www.naed.org. Click on the Foundation/Completed Research link.

As noted previously under the product liability section, where defective or malfunctioning products are concerned, all 50 states have enacted a strict liability standard. This standard can hold the designer, manufacturer, shipper, wholesaler, retailer, and anyone else engaged in the channel for that product strictly liable for the damages sustained by the consumer and, often, bystanders present when the product has failed or malfunctioned.



Further, in many states, it is equally imperative to know that this doctrine may require a party who has been adjudged even **1% responsible** for the injuries and damages sustained as a result of a product failure or malfunction to be responsible for **100% of the verdict**. This can happen if other liable defendants are unable to pay their allocable proportion, do not have available insurance to cover it, or are not subject to the laws and jurisdiction of the United States.

 Thus, this leaves the electrical distributor in a most untenable situation: Unless the proper due diligence and protections have been undertaken, an electrical distributor may very well find itself standing in the shoes of its manufacturer and be forced to defend and pay the resulting claims and losses while also assuming the intended business consequences. This is true whether the manufacturer is a substandard purveyor of electrical products or component parts or even a reputable manufacturer whose insurance or other resources preclude it from helping to make the injured party whole.

B. The Role of Counterfeit Electrical Products

Another dangerous circumstance that can provide added legal exposures to an electrical distributor is when that channel member has dealt knowingly or unknowingly in the sale of counterfeit products. This growing problem is a particular concern to the electrical industry.

One example in which the propensity of “counterfeit” electrical products is increased is in dealing with less than reputable breaker brokers. The broker has, for the moment, taken out of the equation the distributor’s direct access to, contractual relationship with, and protections from the manufacturer. Without the qualitative assurances from the manufacturer or proof the manufacturer whose trademark is on the product continues to stand behind the item, the distributor may once again be relegated to sharing the shoes of the manufacturer with the broker—or will stand in them alone.

The circumstances of counterfeit products touch a variety of interests including injury or death to consumers based upon a product defect or malfunction, deception to buyers of electrical products, improper use of intellectual

property rights, and the loss of tax revenues to federal, state, and municipal governments.

In these circumstances the terms “black market” and “grey market” often come into play. The “black market” is also often referred to as the “underground market” and is the economic activity involving illegal dealings, typically the buying and selling of counterfeit electrical merchandise illegally obtained (e.g., sale of circuit breakers stolen from a trailer or ship container). By contrast, the “grey market” refers to the flow of goods through distribution channels other than those authorized or intended by the manufacturer (e.g., surplus, used, and reconditioned electrical equipment being misrepresented and sold as new has created a grey market within the electrical industry).

The threat of these counterfeit products to consumer health and safety is probably one of the most important dangers. The National Electrical Manufacturers Association, NAED, Underwriters Laboratories, and other industry representatives have been working collaboratively within the channel, with law enforcement, and with domestic and international government officials to track the bad actors and their illegal conduct in an effort to find and prosecute the perpetrators and to tighten the laws and enforcement actions to protect the integrity of the channel.

Examples of documented counterfeit electrical products include:

- *conduit fittings installed in a hazardous location, marked with a brand and certification marks bearing the manufacturer’s part number of a product designed for use in hazardous locations, but not meeting the design requirements suitable for hazardous locations;*
- *circuit breakers bearing a brand name not providing protection;*
- *defective control relays—bearing a counterfeit certification mark—causing a machine to malfunction;*

BLACK MARKET:

often referred to as the “underground market” and is the economic activity involving illegal dealings, typically the buying and selling of counterfeit electrical merchandise illegally obtained.

GREY MARKET:

the flow of goods through distribution channels other than those authorized or intended by the manufacturer.

- *extension cords bearing a brand name and certification mark for a product designed for a 12-gauge wire, but actually employing a smaller 24-gauge wire, catching on fire when the cords are used as intended;*
- *infringing imported dry cell batteries containing mercury, where U.S. law prohibits the sale of such products containing mercury;*
- *illegally infringing or using the service mark of Underwriters Laboratories or other certification facilities on an electrical component or part without authorization;*
- *trafficking in counterfeit extension cords;*
- *counterfeit GFCI plugs in various products including pressure washers;*
- *cell phone batteries; and*
- *no-name products or products with the names of the manufacturer misspelled but also containing certification marks.*²⁸

In research for this white paper, we also spoke with a number of electrical manufacturers and wholesalers taking a proactive role to battle the impact of counterfeit products and component parts. For example, Square D, the flagship brand of Schneider Electric North American Operating Division, became involved with a number of industry groups and organizations to press the U.S. Congress and trade representatives to strengthen the laws and sanctions against manufacturers and sellers of known counterfeit products. In June 2007, Schneider announced that it filed a suit against Breakers Unlimited, Inc., a nationwide wholesale distributor of electrical equipment. The lawsuit alleges that the wholesale distributor knowingly sold counterfeit Square D circuit breakers and infringed on the company's trademarks in violation of federal law. The following industry

Industry trade groups joined together as a unified force to pursue counterfeiters:

- Underwriters Laboratories International
- Anti-Counterfeiting Coalition (IACC)
- NAED
- The National Electrical Contractors Association
- U.S. Chamber of Commerce
- National Electrical Manufacturers Association
- INTERPOL
- U.S. Department of Homeland Security
- Royal Canadian Mounted Police
- International Electro Technical Commission
- British Electro Technical and Allied Manufacturers Assoc.
- National Electrical Manufacturers Association
- Electrical Safety Foundation International

trade groups joined together as a unified force to pursue counterfeiters wherever they reside in the distribution chain: NAED, the National Electrical Contractors Association, U.S. Chamber of Commerce, National Electrical Manufacturers Association, INTERPOL, U.S. Department of Homeland Security, Royal Canadian Mounted Police, International Electro Technical Commission, British Electro Technical and Allied Manufacturers Association, National Electrical Manufacturers Association, Electrical Safety Foundation International, and others.

The United States is not alone in identifying the growing presence of counterfeit electrical products as a major priority and taking action against these bad actors.

In May 2006, the Canadian Anti-Counterfeiting Network (CACN) was launched. The Electro-Federation Canada (EFC) is one of the network's founding members. An article published by CACN in July/August 2006 noted that dollar stores in Canada have become notorious for selling unapproved electrical products, many of which contain counterfeit marks of certification organizations like the Canadian Standards Association (CSA); Underwriter's Laboratories of Canada (ULC); and Technischer Überwachungs-Verein (TUV) from Germany.²⁹

The article also noted that some importers of electrical products developed a grey market for mostly wiring devices, selling suspect and possibly counterfeit electrical products to contractors from the back of their trucks.³⁰ Included in this are the growing

incidents of malfunctioning refurbished molded case circuit breakers (MCCBs), obtained from brokers or unknown or questionable sources. These products are refurbished to give them a new appearance. Personally printed labels are then applied with counterfeit certification

marks and manufacturers' logos. Hospitals and condominiums in British Columbia and Quebec have had MCCBs installed in their facilities purchased from Canadian refurbishers, after the circuit breakers were discarded from flood-ravaged areas around the city of New Orleans for resale in Canada.

The 2004 Ontario Electrical Safety Report—conducted by the country's electrical safety authority—found that electrocution from the use of faulty electrical equipment constituted 10% of occupational fatalities in Canada. The report also pointed out that the predominance of residential electrocution continues, accounting for 32% of all electrocutions in the providence of Ontario between 1995 and 2003.

Creating awareness of these circumstances is the strongest weapon to prevent injuries, damages, and losses attributed to counterfeit electrical products. For the unsuspecting consumer, the risk of fire destroying property or causing injury or even death is substantially enhanced when the manufacturer cannot be traced. In these circumstances, or where the manufacturer can also not be made subject to the jurisdiction of the U.S. courts, the wholesalers once again must answer the call of being sued, retaining and paying for attorneys to defend them and any prospective settlement or jury verdict.

To put the problem of electrical counterfeit or fake products into perspective, one need only go as far as recent statistics of the U.S. Customs and Border Protection Agency noting the rising amount of counterfeit products coming into America. While completely accurate figures are not available due to the nature of the counterfeit "industry," global traffic in counterfeit goods is estimated to be a \$500 billion per year business, growing at a rate of 20% to 25% annually.³¹ In addition, while there is no way to track how much of this is related directly to electrical products or components, the interviews conducted for this white paper indicated that virtually every electrical wholesaler, distributor, and manufacturer contacted is familiar with or has direct experience with counterfeit electrical products.

Another factor can be related directly to counterfeit circuit breakers. Two hundred and fifty thousand circuit breakers can fit into a 40-foot container shipped into the United States aboard a cargo ship. An average home contains

15 circuit breakers; 16,666 homes can be impacted by one container of circuit breakers.

Five hundred thousand circuit breakers have been seized in the United States by U.S. Customs and Border Protection between January 2006 and June 2007. While electrical products probably account for only a small



trafficking counterfeit goods



16,666

HOMES CAN BE IMPACTED BY
ONE CONTAINER OF CIRCUIT BREAKERS



\$500 billion per year

ESTIMATED GLOBAL
COUNTERFEIT PRODUCTS



20-25%

ANNUAL COUNTERFEIT GROWTH RATE



99.9%

OF DISTRIBUTORS, MANUFACTURERS &
WHOLESALEERS HAVE ENCOUNTERED
COUNTERFEIT ELECTRICAL PRODUCTS



500,000

CIRCUIT BREAKERS SEIZED BY U.S.
CUSTOMS BETWEEN 01/2006 - 06/2007



\$200-400 million

TOTAL VALUE OF COUNTERFEIT
ELECTRICAL PRODUCTS IMPORTED

fraction of that market, some estimates we have seen in our research bring the total value of counterfeit electrical products imported into the United States to \$200 million to \$400 million. However, given the potential for health and safety implications, the issue continues to gain prominence.

Sophisticated identification systems are being built into the labels of Underwriters

Laboratories in order for customs agents and others to better ascertain the veracity of an electrical product. The International Anti-Counterfeiting Coalition (IACC) in Washington, D.C., is also working to create more public awareness and helping in the prosecution of criminals who traffic counterfeit electrical products.

The legal consequences for selling counterfeit products are substantial. Aside from the injuries sustained by third parties when a counterfeit product has malfunctioned, the counterfeit manufacturer and/or electrical distributor can be subject to federal imprisonment and monetary penalties for violation of federal law.

In March 2006, the Stop Counterfeiting in Manufactured Goods Act was passed by the U.S. Congress and signed into law shortly thereafter. The law strengthens remedies for counterfeiting, allowing law enforcement agencies:

- *to seize a product if it is shown to be counterfeit even if not proven in court;*
- *to seize and destroy machinery and tools used in the production of counterfeit products; and*
- *to take money gained in the sales of counterfeit products.*

The language of the actual statute is very clear: **“whoever intentionally traffics or attempts to traffic in goods or services and knowingly uses a counterfeit mark on or in connection with such goods or services, or intentionally traffics or attempts to traffic in labels, patches, stickers, wrappers...boxes, containers...documentation, or packaging of any type or nature, knowing a counterfeit mark has been applied thereto, the use of which is likely to cause confusion, to cause mistake, or to deceive, shall, if an individual, be fined not more than \$2 million or imprisoned not more than 10 years, or both, and, if a person other than an individual, be fined not more than \$5 million”** (18 U.S.C. § 2320).

Further, forfeiture of counterfeit products is also a remedy when the federal government steps in to seize it. Federal law is clear: No property rights exist in any article bearing or consisting of counterfeit marking.

C. Trademarks and Intellectual Property

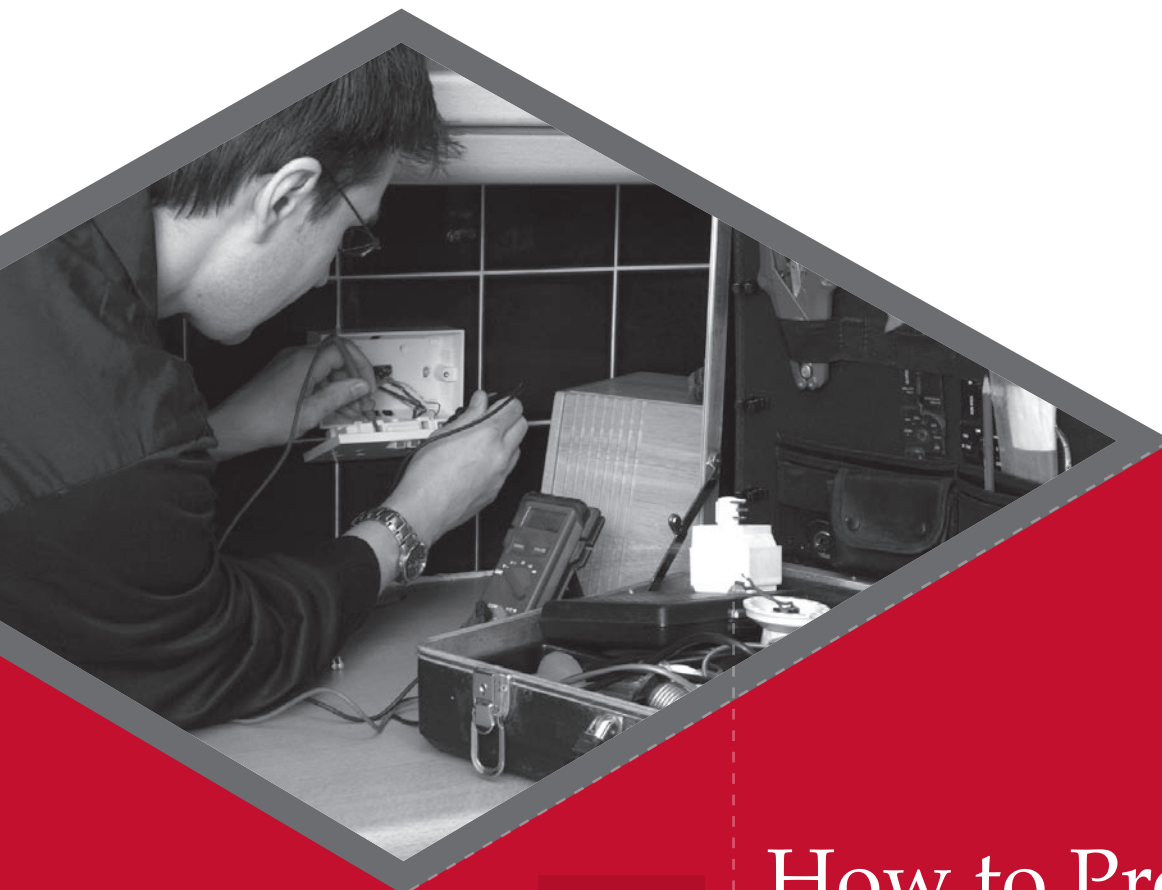
In the case of trademark or intellectual property violations, civil actions are also permitted arising out of the use of counterfeit marks. The federal statute notes that the use of such marks in connection with the sale, offering for sale, or distribution of goods or services provides any federal court with the competent

jurisdiction and authority to grant an order providing for the immediate seizure of goods and counterfeit marks involved in such violation. The court can also take the means of making those marks and records and documenting the manufacturing, sale, or receipt of things involved in such violation.

Therefore, an electrical distributor can lose its inventory based upon a seizure order entered by a federal court. And, if the products are shown to be unsafe, the U.S. Consumer Product Safety Commission can also order an immediate recall from every customer who purchased those products, in respect of whether the importer or distributor knew them to be counterfeit.

The laws allow the manufacturer of a product bearing a legitimate trademark or intellectual property to be afforded a defense where the malfunction of a counterfeit product causes injury, loss, or damage as it had no involvement in selling the counterfeit product. Therefore, electrical wholesalers and distributors, retailers, shippers, and others in the domestic supply chain can then be left with the entire liability risk if the manufacturer of the fraudulent and counterfeit products cannot be found or sued in the United States.

“*...electrical wholesalers and distributors, retailers, shippers, and others in the domestic supply chain can then be left with the entire liability risk if the manufacturer of the fraudulent and counterfeit products cannot be found or sued in the United States.*”



How to Protect Yourself from Counterfeit Electrical Products³¹

PRODUCT LIABILITY EXPOSURE:

How to Manage and Mitigate the Risks in Today's Global Market

CHAPTER SEVEN HIGHLIGHTS:

- >> Proactive Measures
- >> Specific Counterfeit Indications
- >> Recall of Electrical Components
- >> Costs & Requirements

Perhaps the most valuable measure to minimize the risk of being involved in a counterfeit product scheme or unknowingly buying counterfeit products is to:

1. *know the manufacturer; and*
2. *know the seller if not obtained directly from the manufacturer.*

The electrical wholesale channel is still an industry prefaced primarily upon professional relationships. A distributor can protect its balance sheet and corporate reputation by ensuring that a forensic due diligence examination has been performed of the source of the products being purchased. Other proactive measures include:

- ✓ **ask** for and retain samples of a product being purchased, have the sample **evaluated and tested**, and then **compare** the sample to the actual products delivered;
- ✓ do some **research** to find out whether the manufacturer or seller of the product is known in the channel to deal in these types of goods;
- ✓ **watch** for irregular product items and/or packaging, such as:
 - *unusual warranty claims, spelling errors on the product or packaging,*
 - *the weight of the product—as counterfeit goods usually weigh less than the genuine product it is attempting to imitate due to the lack of component parts and materials that are usually contained in the genuine product—or the use of inferior substitutes;*
 - *inconsistent or irregular UL marks appearing on the product, failure to use the word “LISTED,”*
 - *failure to adequately describe the product identity to have a unique alpha numeric control or issue number assigned by UL to the products it certifies³³;*
- ✓ **double-check** the name and validity of the name and contact information of the manufacturer;
- ✓ **avoid** bargains that substantially avoid the price of electrical products, which is usually a clear sign of counterfeit or defective products;
- ✓ **avoid** no-name products;
- ✓ **avoid** vendors who are not willing to grant refunds for electrical products not performing as they should;
- ✓ **employ** the concept of “strict liability” for the failure to deliver authentic components and parts in contracts and **hold sellers responsible** for fraudulent goods;
- ✓ institute shipping policies to **protect** the integrity of component parts and other materials by using seals on all containers and noting the serial numbers on shipping manifests to protect containers from being opened and resealed;
- ✓ fully **inspect** all carrier documents;
- ✓ **verify** the authenticity of the product;
- ✓ **authenticate** distribution partners;
- ✓ **monitor** brand integrity by collaborating with local customs authorities, providing information about suspected or known “bad actors,” and enhance market intelligence by sharing information with other channel partners;
- ✓ consider using technology to **ensure product security** by applying low-cost solutions helping differentiate authentic products from counterfeit products; also include the use of barcode symbologies such as Reduced S Symbology (RSS) and other globally recognized Two D Composite Symbologies and radio-frequency identification (RFID) tags, holograms, and watermarks; and
- ✓ **maintain** relationships with incumbent, recognized, and industry manufacturers, suppliers, sellers, shippers, and retailers.³⁴



U.S. Customs and Border Protection and ICE units made more than 14,000 seizures in counterfeit goods worth in excess of \$155 million, a 67% increase compared to 2005. These investigations resulted in 219 arrests, 134 indictments, and 170 convictions in intellectual property rights violation, representing a 71% increase in the conviction rate over 2005.

Trademark counterfeiting also reached the electrical sector. A presentation on “Consumer Products: Counterfeit Problems and Anti-Dumping Measures,” presented before the Worldwide System for Conformity Testing and Certification of Electrical Equipment (IECEE) in Berlin, Germany, in 2006 noted that counterfeit electrical products impact both well-known industrial and consumer brands as well as registered certification marks of IECEE-registered certification bodies. These counterfeit electrical products can generate significant safety hazards and, left undetected, can cause deaths, injuries, and substantial property loss in both the home and commercial establishments.

Although counterfeit electrical products may appear as indiscernible copies of the genuine article, market control and investigations show that many are substandard and have not passed U.S. Immigration and Customs Enforcement (ICE) safety requirements. While detection based upon appearance is extremely difficult and may only be determined after inspecting each suspicious product, a more immediate way in which to detect a fraud is to conduct relevant safety tests.³⁵

Estimates as to the sales of counterfeit electrical products worldwide and in North American vary widely. However, most estimates, while conservative, project the amount of global counterfeiting of electrical products between \$11 billion and \$20 billion annually, and between \$300 million and \$400 million in North America.³⁶

The Internet and various electrical component and product trade fairs are new means by which counterfeiters are selling their product. Third-world commodity export fairs include “vendors” who may be willing to place an unauthorized certification mark for trademark on similar-looking products or packaging.

Other indications of a potentially counterfeit product include:

- >> manufacturers who do not offer or honor product warranties;
- >> training programs to distributors and customers on the safe use and maintenance of products; and
- >> testing and conducting quality control and inspections of branded products even if sourced from a third-party manufacturer.³⁷

As evidence this effort is attaining international stature, the Arabian Anti-Piracy Alliance (AAA) has also implemented a comprehensive program along with United Arab Emirates authorities to fight the presence, manufacture, and sale of counterfeit electrical components. The Alliance has been joined by Schneider Electric; ABB; Delta Electrical, Limited; Hager; F & G; Clipsal; Dorman Smith Switchgear; Electrium; and Legrand/Tenby.³⁸

The Department of Homeland Security announced in fiscal year 2006 that their U.S. Customs and Border Protection and ICE units made more than 14,000 seizures in counterfeit goods worth in excess of \$155 million, a 67% increase compared to 2005. These investigations resulted in 219 arrests, 134 indictments, and 170 convictions in intellectual property rights violation, representing a 71% increase in the conviction rate over 2005. The Lawrence Livermore Laboratory recently released a list of electrical items most commonly involved in potential counterfeit scenarios:

ELECTRICAL ITEMS INVOLVED IN COUNTERFEIT SCENARIOS

- Motor control centers
- Complete units (self-contained electrical packs)
- Electrical component parts
- Starters
- Starting coils
- Overload relays
- Starter control relays
- Overload heaters
- Protective/control relays
- DC power supplies/chargers
- AC inverters
- Current/potential transformers
- Exciters/regulators
- Bus transfers/auto bus transfers
- Motor generators sets
- Generators
- Rewindable motors
- Printed circuit boards
- Fuses
- Spliced vacuum breakers (BWRs)
- Indicators/controllers
- Panel lights/switches
- Transmitters/instrument switches
- Isolation devices

ELECTRICAL COMPONENTS

General Suspect/Counterfeit Indications

- Screwdriver marks on terminals
- Different screw types or materials on terminals
- Handwritten or typed rather than stamped tags
- Missing tags (usually UL-approved tag)
- Fitted or worn contacts and lugs
- Not in manufacturer's box or container
- Signs of paint or smoke
- Insufficient nameplate information
- Missing terminals
- Screws used in place of rivets
- Body worn or discolored
- Rough metal edges
- Scratched or marred surfaces
- Metal color inconsistencies
- Modified or restamped nameplates
- Improper fastening of nameplates
- Plastic parts of different colors
- Discolored or faded manufacturer's labels
- Past due calibration stickers (internal and external)
- Broken or damaged solder terminations
- Broken or damaged termination lugs
- Contact surfaces not mating properly
- Lubrication appearing to be old
- Shipping in plain packaging (no manufacturer barcode)
- Used or damaged parts in new packaging

SPECIFIC SUSPECT/COUNTERFEIT INDICATIONS

Molded Case Circuit Breakers

- Handle modified to change ampere rating
- Style is no longer manufactured
- Unusual packaging, bulk packaging, generic packages, and cheap appearance
- Refurbisher's name on breaker
- Broken seal between halves
- Contradicting amperage ratings

Fuses

- Label missing or weathered
- Wear marks on bases

Power (Draw out) Circuit Breakers

- Different color or shape of overcurrent devices
- Suspicious-looking auxiliary trip devices

Motor Starters

- Poor fitting or wrong voltage-rated operating coil

Motor Control Centers

- Breakers not easily opened or closed with compartment door closed
- Exposed buss work with compartment doors open

Electromechanical Relays

- Poor- or loose-fitting relays

Potter-Brumfield Relay

- Sloppy coil lead solder joints
- Painted relay base grommets (normally clean)
- Terminal strips fastened with eyelets
- Painted rivets fastening the terminal strip to the relay housing
- Termination screws in brown paper bags (should be clear; heat-sealed plastic bags)
- Use of bubble wrap (plastic Styrofoam should be used)
- Repainted inner bell surface
- Missing or inconsistent date codes, inspection stamp, and test stamp
- Incorrect shaft cover clearance, shaft play, and lack of bearing lubricant
- Tops of rotor shafts painted a color other than black
- Nonuniform numbers stamped on the contact decks, indicating decks made up from various relays
- Incorrect coil (i.e., 125 VDC relay with 200 VDC coil)

Capacitors:

- Polished surfaces scratched or dented
- Termination lugs scarred
- Buildup of debris and dirt in termination guards
- Plain packaging (no manufacturer barcodes)

DOCUMENTATION AND CERTIFICATION:

General Suspect/Counterfeit Indications

- Use of correction fluid or correction tape
- Type style or pitch change is evident
- Documentation has missing (or illegible) signature, initial, or data
- Document is excessively faded or unclear
- Inconsistent technical data
- Certification or test results are identical between items when normal variations should be expected
- Document is not traceable to the items procured
- Technical data are inconsistent with code or standard requirements
- Documentation is not delivered as required on the purchase order, or in an unusual format
- Lines on forms are bent, broken, or interrupted, indicating data have been deleted or exchanged by “cut and paste”
- Handwritten entries are on the same document where typed or preprinted data exist
- Data on a single line are located at different heights
- Product recall
- Chemical alloy composition totals 100% (or >99.75%) as shown on Certified Material Test Report (CMTR)
- Heat and lot numbers are same for different materials in same order (i.e., 6010 and 7018 weld wire cannot be manufactured from same heat and lot of material)

A. The Recall of Electrical Components and Products

During the summer of 2007, trade press documented the increasing number of recalls being undertaken by both state and federal governments of defective products manufactured both domestically and internationally. Recalls are undertaken by statutorily authorized agencies like the U.S. Consumer Product Safety Commission, the Food and Drug Administration, the Department of Transportation, and others, when notification has been made of a malfunction, defect, injury, or death to a third party, or property damage occasioned to a commercial enterprise.

Given the increase in private labeled products being contracted to overseas manufacturers, the amount of electrical products being recalled has similarly and proportionately increased.

Examples of recalls in 2007 by the CPSC include:

Home Decorators Collection of Sconces:

- >> Distributed by Home Decorators Collection of St. Louis, Mo.
- >> Recall is due to a missing back plate, which can expose consumers to live wires, posing a risk of electrical shock to those who might be changing a light bulb.
- >> The products are noted to have been manufactured in China.

Carlon® in-floor boxes:

- >> Manufactured by Lamson & Sessions of Cleveland, Ohio
- >> Recall is due to the floor boxes being wired incorrectly resulting in a reverse of polarity and posing a shock or electrocution hazard to consumers.
- >> The product was manufactured in China.

Counterfeit “Square D” circuit breakers:

- >> Distributed by Scott Electric Company, Inc. of Greensburg, Pa.
- >> Recall is due to the fact that the recalled circuit breakers labeled “Square D” are counterfeit and might not trip when they are overloaded, posing a fire hazard to consumers.
- >> The product was manufactured in China.

“Aloha Breeze” portable electric heaters:

- >> Distributed by Aloha Housewares, Inc., of Arlington, Texas
- >> Recall is due to the fact that the distributor has received reports of the heaters melting, smoking, or catching fire, including one report of minor property damages having taken place as a result of the malfunction.
- >> The product is manufactured in China.

Toe-Space Electric Heaters:

- >> Manufactured by Berko Electric of Purdue, Ind./ Marley Engineered Products of Bennettsville, S.C.
- >> Recall is due to the manufacturer having received 29 reports of fires resulting in property damages when the fans stopped working but the heater continued to run, causing the unit to overheat and causing a fire hazard.
- >> The product is manufactured in the United States.

The CPSC is charged with protecting the public from unreasonable risks of serious injury or death for more than 15,000 types of consumer products under the agency's jurisdiction. These include electrical products and component parts. Deaths, injuries, and property damage from consumer product incidents cost the United States more than \$700 billion annually.³⁹

its product safety recalls involved products imported from overseas. Memoranda of understanding have now been entered into with trading partners in Mexico and China as well as other countries to encourage manufacturers in those countries to observe and comply with U.S. safety standards including both mandatory and relevant voluntary standards.

the cost of consumer product incidents



\$700 billion

U.S. ANNUAL COST FROM DEATHS, INJURIES AND PROPERTY DAMAGE FROM CONSUMER PRODUCT INCIDENTS



30 deaths

FROM FIRE INCIDENTS INVOLVING ELECTRICAL PRODUCTS



140 injuries

FROM FIRE INCIDENTS INVOLVING ELECTRICAL PRODUCTS



\$75.2 million


PROPERTY LOSSES AS A RESULT OF PRODUCT MALFUNCTIONS

As a new initiative, the CPSC has identified the need to investigate the causes of fire incidents involving electrical lighting products. The agency has identified 30 deaths, 140 injuries, and \$75.2 million in property losses having been sustained as a result of product malfunctions since 2003.⁴⁰

Other initiatives include extension cord malfunctions allegedly responsible for over 3,100 fires in 2002. In its 2006 Annual Report, the agency noted that roughly two-thirds of

Electrical distributors and wholesalers should stay abreast of all electrical product recalls by the CPSC. This can be done easily by subscribing to the free list serve at www.cpsc.gov/cpsclist.aspx, which will then allow the reader to obtain all blast emails of recalled products and the reasons why the recall is taking place. The electrical distributor can then review its respective inventories to ensure none of these products or SKUs is in its inventory.⁴¹

The penalties that can be imposed by the federal or state government agencies pursuant to a recall of a malfunctioning or defective product are also substantial. An electrical distributor could face any or all of the following costs and requirements:

- 
- >> The prohibition of doing business in the channel in the future;
 - >> Becoming a witness in the criminal trials of counterfeiters, importers, and brokers;
 - >> The potential of having no insurance coverage for actions excluded by the policy, and facing the prospect of no insurance coverage being provided for the damages and losses incurred, unless a specific recall insurance policy has been obtained;
 - >> Lost profits and legal expenses of the trademark right holder;
 - >> Investigation and voluntary recall costs imposed by the CPSC;
 - >> Notification to all of the electrical distributor's customers that a particular product sold has now been recalled;
 - >> Turning over the entire customers and sales lists to the federal government for review;

- >> Assisting a retailer or other customers in ascertaining whether any of the defective products subject to a recall may have been contained with other legitimate or genuine products;
- >> Restitution of attorneys' fees and prosecutorial costs of the government;
- >> Cooperating in federal seizure orders of an entire inventory and not just the suspected counterfeit products;
- >> Facing the prospect of an incumbent manufacturer's decision to pull the contract or grant of authority to the electrical distributor who has now violated the provisions of that agreement by dealing with a counterfeit or other manufacturer whose product has been subject to recall; and
- >> Facing the prospect of other monetary and statutory fines under the Lanham Act, 42 racketeering influenced and corrupt organizations statutes, fraud, misrepresentation, and trademark infringement.

Therefore, the consequences are staggering to electrical distributors who sold a product or inventory line recalled by the federal government. These industry businesses face the prospect of substantial fines, penalties, business interruption, lost customers and profits, loss of reputation and goodwill, and other damages for their role. These consequences can occur whether their role was intentional or not.

“The electrical wholesale channel is still an industry prefaced primarily upon professional relationships. A distributor can protect its balance sheet and corporate reputation by ensuring that a forensic due diligence examination has been performed of the source of the products being purchased.”

ELECTRICAL DISTRIBUTORS AND WHOLESALERS SHOULD STAY ABREAST OF ALL ELECTRICAL PRODUCT RECALLS BY THE CPSC. THIS CAN BE DONE EASILY BY SUBSCRIBING TO THE FREE LIST SERVE AT **WWW.CPSC.GOV/CPSCLIST/ASPX**, WHICH WILL THEN ALLOW THE READER TO OBTAIN ALL BLAST EMAILS OF RECALLED PRODUCTS AND THE REASONS WHY THE RECALL IS TAKING PLACE. THE ELECTRICAL WHOLESALER CAN THEN REVIEW ITS RESPECTIVE INVENTORIES TO ENSURE NONE OF THESE PRODUCTS OR SKUS IS IN ITS INVENTORY.



INSURANCE

Insurance Issues

PRODUCT LIABILITY EXPOSURE:


*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER EIGHT HIGHLIGHTS:

- >> Commercial General Liability Policy
- >> Certificate of Liability Insurance
- >> Cancellation of Insurance by the Manufacturer
- >> Best Practices
- >> Vendors' Endorsements

Liability risks and exposures for electrical distributors, and most other commercial enterprises, are usually transferred to an insurance company with adequate security to respond to valid claims and suits triggering a policy's insurance agreements. In this section, we review the nature and types of coverage usually utilized, and ways for electrical distributors to work with their own insurance risk manager, broker, or agent. The section helps distributors know that their rights and interests are adequately protected based on the nature of business transactions conducted, the types of products sold, and the nature of additional services provided to customers.

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 **An annual audit of the distributor's own insurance protections is strongly recommended, along with a review of the coverage being afforded by the manufacturers with which the distributor has a contractual relationship. This will confirm the extent of financial protections in place before a claim or lawsuit arrives, allows for the opportunity to shore up any gaps, and eliminates any future unexpected "surprises."**

A. Commercial General Liability Policy

The basic concept of insurance is provided by a commercial general liability (CGL) insurance policy, which affords, among other things, for the defense of a lawsuit or proceeding and the payment—"indemnification"—of any prospective settlements and verdicts. One of the common policies utilized is the ISO CG 00 01 10 01 form,⁴³ which states in pertinent part as follows:

"SECTION I—COVERAGES COVERAGE OF A BODILY INJURY AND PROPERTY DAMAGE LIABILITY

I. Insuring Agreement

A. We will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies. We will have the right and duty to defend the insured against any 'suit' seeking those damages.

However, we will have no duty to defend the insured against any 'suit' seeking damages for 'bodily injury' or 'property damage' to which this insurance does not apply. We may, at our discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result. But:

1. The amount we will pay for damages is limited as described in Section;
2. Limits of Insurance; and
3. Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C."

Definitions:

It is important to review the definitions of these matters to put them into the proper context.

II. “Your product”:

A. means:

1. any good or products, other than real property, manufactured, sold, handled, distributed, or disposed of by:
2. you;
3. others trading under your name; or
4. a person or organization whose business or assets you have acquired; and
 - a. containers (other than vehicles), materials, parts, or equipment furnished in connection with such goods or products.

B. includes:

1. warranties or representations made at any time with respect to the fitness, quality, durability, performance, or use of “your product”; and
2. the providing of or failure to provide warnings or instructions.

III. “Your work”:

A. means:

1. work or operations performed by you or on your behalf, and materials, parts, or equipment furnished in connection with such work or operations.

B. includes:

1. warranties or representations made at any time with respect to the fitness, quality, durability, performance, or use of “your work”; and
 - a. the providing of or failure to provide warnings or instructions.

IV. “Impaired property”:

A. means:

1. tangible property, other than “your product” or “your work,” that cannot be used or is less useful because:
 - a. it incorporates “your product” or “your work” that is known or thought to be defective, deficient, inadequate, or dangerous; or
 - b. you have failed to fulfill the terms of a contract or agreement.
2. if such property can be restored to use by:
 - a. the repair, replacement, adjustment, or removal of “your product” or “your work”; or
 - b. your fulfilling the terms of the contract or agreement.

A review of the foregoing information reveals the limitations of insurance coverage provided by the traditional commercial general liability insurance policy, compared to the array of risks and exposures faced by electrical distributors. Therefore, in the circumstance of exposures electrical distributors face in today’s litigious environment and global economy, it is essential to appreciate those risks to which the policy is precluded from responding, in order that arrangements can be made to obtain the other protections needed.

Whether for the manufacturer or the distributor, the risk manager, insurance broker, or agent can best advise whether additional coverage should be secured. These would include separate product liability insurance,⁴⁴ excess or umbrella insurance,⁴⁵ and product recall insurance⁴⁶ for the added coverage these policies can provide to the distributor as needed. Product recalls also bring with them a unique set of additional exposures and consequences. Recall insurance can afford protection for:

- *recall costs like media announcements and public relations specialists, transportation, rebates, warehousing costs, employee overtime, inspection and destruction costs, and third-party recall costs;*
- *loss of net profit due to the recall;*
- *rehabilitation of the brand, like sales and marketing expenses necessarily incurred to re-establish the reputation and market share of the affected product and advertising campaigns, special promotions, and consumer education; and*
- *crisis response expenses and fees of outside consultants retained exclusively for the purpose of responding to the product recall.*

B. The Certificate of Liability Insurance

As noted previously, most manufacturers will effectuate a contractual relationship with an electrical distributor, which will contain a vendor’s endorsement and/or name the distributor as an “additional insured” to its respective insurance policy, and, as evidence thereof, may forward a certificate of liability insurance representing the naming of the distributor as a “certificate holder.”⁴⁷

As noted on the form Certificate of Liability Insurance:

"THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES [LISTED] BELOW."

Many erroneously believe being an "additional insured" under a manufacturer's policy will protect them in a product liability case. Distributors assume the certificate of insurance is "enforceable" against that very same supplier and/or its insurance provider when they are sued in such a case. Nothing could be further from the truth. The fact is that the certificate of liability insurance merely provides "evidence" of insurance, not proof of insurance. However, the certificate expressly reads "provides no rights to its holder."⁴⁸ Therefore, in the event that the manufacturer, its insurance broker, or its insurance company has not listed the distributor as an additional insured by a formal endorsement attached to and made part of the insurance policy of the manufacturer, the purported certificate of liability insurance will have no value or effect.

In addition, at no time will the distributor be advised as to the impairments or exhaustion of the limits of liability under the manufacturer's insurance policy based upon other claims, settlements, verdicts, and expenses that are paid out of the limits of liability under the policy to which the distributor is not a party or would have no first-hand knowledge. For example, a \$1 million limit of liability insurance policy for a manufacturer may be incrementally depleted or entirely exhausted during the course of

the policy period based upon a variety of all valid claims and expenses triggering the manufacturer's policy—without any knowledge by or notice to the distributor.

There is also no duty or obligation for either the manufacturer or its insurance company to advise the electrical distributor of any cancellation of the insurance policy during the pendency of the policy period. The only provision stated on the certificate of liability insurance notes the following:

"CANCELLATION: SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING INSURER WILL ENDEAVOR TO MAIL ____ DAYS WRITTEN NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT

FAILURE TO DO SO SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE INSURER, ITS AGENTS OR REPRESENTATIVES."

C. Cancellation of Insurance by the Manufacturer

In the course of our research, we also discussed with brokers, underwriters, and Syndicate representatives at Lloyd's of London, the current state of insurance issues of electrical distributors. Aside from being advised of existing circumstances in the channel from their

perspective, information was also provided on a current scheme being utilized by some offshore manufacturers in respect of naming U.S. electrical distributors as additional insureds to the policies of the manufacturer.

Once the contractual arrangements of the transaction have been agreed upon, the manufacturer contacts its insurance broker to have the U.S. distributor added as an additional

Did you know?

➤ In the event that the manufacturer, its insurance broker, or its insurance company has not listed the distributor as an additional insured by a formal endorsement attached to and made part of the insurance policy of the manufacturer, the purported certificate of liability insurance will have no value or effect.

➤ At no time will the distributor be advised as to the impairments or exhaustion of the limits of liability under the manufacturer's insurance policy based upon other claims, settlements, verdicts, and expenses that are paid out of the limits of liability under the policy to which the distributor is not a party or would have no first-hand knowledge.

➤ There is also no duty or obligation for either the manufacturer or its insurance company to advise the electrical distributor of any cancellation of the insurance policy during the pendency of the policy period.

insured to its policy. A certificate of liability insurance is then prepared in the normal course and issued to the distributor.⁴⁹ We were advised that once the products leave the custody of the manufacturer and are shipped to the United States, the manufacturer will advise its insurance broker to cancel the policy or additional insured endorsement.

When a claim or lawsuit arises in the future due to a product defect or malfunction, the distributor will, in the ordinary custom and practice, tender the claim or lawsuit to the manufacturer or its insurance carrier for defense and indemnification pursuant to the vendor's endorsement provision of the contract,⁵⁰ the additional insured endorsement in the policy, and the certificate of liability insurance. Unfortunately, even if the manufacturer is still in business, its insurance policy and/or promise to hold the distributor harmless and provide a defense and indemnification have been cancelled and are no longer in place to protect the distributor.

This is another situation where if the manufacturer is outside the jurisdiction of U.S. courts and unable to be sued, the electrical distributor will be relegated to step into the shoes of its former business partner and be held to answer for any damages and costs to any and all injured parties. In this "Perfect Storm" scenario, the distributor will hopefully now have its own insurance program established in a manner to respond to this circumstance; otherwise, it will have only its own assets to fall back on.⁵¹

D. Best Practices

Therefore, it is strongly recommended that rather than relying on the less than complete protection of a certificate of liability insurance and the other contractual provisions, the electrical distributor require:

- **the manufacturer to provide documentary confirmation of "valid and collectible" insurance, rather than mere "evidence" of insurance;**
- **since its substantive rights may be affected, it be advised of any amendment, cancellation, or nonrenewal of the insurance policy to which it has been added as an additional insured⁵²;**
- **a full and complete copy of the declarations page of the manufacturer's insurance policy**

be provided; and

- **the distributor ensure the contract with the manufacturer contain all the requisite components necessary to protect the wholesaler; namely, the manufacturer hold harmless, defend, and indemnify the distributor in the event of any seizures, forfeitures, recalls, claims, and lawsuits.**

Further, it is advisable to obtain and understand exactly:

- *the nature and type of insurance policy issued to the manufacturer to which the distributor is being named as an additional insured;*
- *the name and A.M. Best security rating of the insurer;*
- *the policy number;*
- *the monetary limits of liability of the policy;*
- *the policy period;*
- *the applicable deductible or self-insured retention⁵³;*
- *any exclusions relevant to the relationship to be undertaken with the manufacturer;*
- *any excess or umbrella insurance policies to which the distributor should also be named as an additional insured; and*
- *the name, address, telephone number, email, and telefax number of the manufacturer's insurance broker and insurance company.*

This information can then be provided to the distributor's risk manager and insurance broker for further protection. The information will also be relevant to the electrical distributor's own insurance company in establishing the risk exposure and premium for the distributor. Further, it will show the nature and extent of coverage in place on products being sold so the risk manager and broker can evaluate the adequacy of coverage and arrange to fill in any gaps. It will also permit the distributor to make contact with the manufacturer's insurance company representatives to ensure that the manufacturer's coverage is in place and when questions, claims, or lawsuits arise. Thus, for the reasons noted above, the electrical distributor must remain vigilant as to the issue of the validity, adequacy, and collectability of its manufacturer's insurance limits of liability.



E. Vendors' Endorsements

Many contracts between manufacturers and distributors contain a "vendor's endorsement" provision. In these circumstances, the endorsement or contractual wording requires the manufacturer to afford additional insured status to the distributor, thus triggering the duty to defend and indemnify the distributor in the event of a prospective claim or law suit.

By operation, the endorsement⁵⁴ extends the commercial general liability policy and existing products liability insurance of the manufacturer to protect, cover, defend, and respond when specifically named vendors have been added to a schedule appended to and made part of the policy, as additional insureds for bodily injury or property damages arising out of the specifically named products of the manufacturer.⁵⁵ This coverage is over and above and applies prior to any similar coverage obtained by and for the distributor to cover its own risks.

The vendor's endorsement may also be limited to exclude coverage for certain occurrences or conduct such as the unauthorized sale or distribution of a product, acts changing the condition or appearance of the product, and a failure to maintain the product in merchantable condition. One of the more common vendor's endorsements⁵⁶ in use today states as follows:

**"POLICY NUMBER
COMMERCIAL GENERAL LIABILITY
THIS ENDORSEMENT CHANGES THE
POLICY. PLEASE READ IT CAREFULLY.
ADDITIONAL INSURED VENDORS."**

This endorsement modifies insurance provided under the following:

**"COMMERCIAL GENERAL LIABILITY
COVERAGE PART
PRODUCTS/ COMPLETED OPERATIONS
LIABILITY COVERAGE PART
SCHEDULE**

NAME OF PERSON OF ORGANIZATIONS [Vendor]: YOUR PRODUCTS:

[If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.]

WHO IS AN INSURED [Section II] is amended to include as an insured any person or organization [referred to below as vendor] shown in the Schedule, but only with respect to "bodily injury" or 'property damage' arising out of 'your products' shown in the Schedule which are distributed or sold in the regular course of the vendor's business, subject to the following additional exclusions:

The insurance afforded the vendor does not apply to:

- 'bodily injury' or 'property damage' for which the vendor is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages the vendor would have in the absence

of the contract or agreement;

- any express warranty unauthorized by you;
- any physical or chemical change in the product made intentionally by the vendor;
- repackaging, unless unpacked solely for the purpose of inspection, demonstration, testing, or the substitution of parts under instructions from the manufacturer, and then repackaged in the original container;
- any failure to make such inspections, adjustments, tests, or servicing as the vendor has agreed to make normally or undertakes to make in the usual course of business, in connection with the distribution or sale of the products;
- demonstration, installation, servicing, or repair operations, except such operations performed at the vendor's premises in connection with the sale of the product;

“

It is therefore essential for the electrical distributor to advise its risk manager and broker of the exact nature and complete extent of products sold, services performed, and the identification of all manufacturers and brokers of products being sold to the public and commercial entities.

”

- products that, after distribution or sale by you, have been labeled or relabeled or used by a container, part, or ingredient of any other thing or substance by or for the vendor; and
- this insurance does not apply to any insured person or organization from whom you have acquired such products, or any ingredient, part, or container entering into, accompanying, or containing such products.”

As noted above, there are several actions that, if undertaken by the distributor, can possibly negate the protections expected. Nevertheless, the specific vendor’s endorsement used can also vary the protections and indemnifications afforded. It is therefore essential for the electrical distributor to advise its risk manager and broker of the exact nature and complete extent of products sold, services performed, and the identification of all manufacturers and brokers of products being sold to the public and commercial entities. Only in this way can the proper arrangements be made to ensure that the risks and exposures of the distributor are covered to the fullest extent possible. Otherwise, the wholesaler will be relegated to the position of prospectively insuring itself for those exposures that should have—or possibly could have—been indemnified by others.

“*The vendor’s endorsement may also be limited to exclude coverage for certain occurrences or conduct such as the unauthorized sale or distribution of a product, acts changing the condition or appearance of the product, and a failure to maintain the product in merchantable condition.*”



Observations, Conclusions, and Recommendations

PRODUCT LIABILITY EXPOSURE:

*How to Manage and Mitigate the
Risks in Today's Global Market*

CHAPTER NINE HIGHLIGHTS:

- >> Managing Product Liability
- >> Top 10 Recommendations
- >> The Educated and Prepared Electrical Distributor

Managing product liability exposures must be both a priority and an essential component of every electrical distributor's strategic and tactical operation. This white paper has substantiated the need for extreme diligence by the distributor to obtain and understand exactly what it is dealing with and the nature of its business operations and financial protections. The day may well come when the distributor unwittingly becomes legally, financially, and corporately responsible for everything the manufacturer has—or has not—done. Where the potential exists for voluntary recalls or involuntary seizures and forfeitures, the impact on the brand integrity, business reputation, and trusted goodwill of the distributor can be catastrophic and business ending to the enterprise.

The following “Top 10” recommendations are offered to channel members as tools to better understand and manage or mitigate prospective risk exposures:

1 Undertake an independent evaluation by experts who understand the channel to assess potential exposures from products sold and services provided in the various regions and states in which the distributor does business.

- ✓ *Review the issue with your risk manager, insurance broker, and outside experts in the channel who can provide an unqualified appraisal of whether existing protections are appropriate to ensure the propriety of the distributor's legal rights, contractual rights and responsibilities, and insurance coverages from both a primary and an excess/umbrella perspective.*
- ✓ *A complete examination must also be made of the services the distributor is providing to its customers (e.g., storeroom management, site visits, training, repackaging, testing, etc.), so as to ensure that these are not creating more liability prospects and, if they are, ensure that adequate protections are in place for these services, as they traditionally will not be ones, even under conventional circumstances, for which a manufacturer would defend, indemnify, or hold its distributor harmless.*
- ✓ *The review must also include an analysis of the statutes, laws, and litigation environment of the state(s) in which the distributor does business, where its retailers conduct their business, and, if possible, the states in which the products are being sold, so as to provide a better analyses of the circumstances producing risk exposures.*
- ✓ *Examination must also include the terms and conditions of the distributor's own insurance policy to determine its adequacy and responsiveness for the specific actions of the distributor, and the extent to which it will afford protection in the event the manufacturer or its insurance company will not.*

2 Examine the contracts and strength of indemnification agreements/vendors endorsements/additional insured endorsements with manufacturers.

- ✓ *The company's general counsel or outside attorney should work collaboratively with senior management and the distributor's insurance broker to review BOTH the existing and future contracts and insurance policy wordings as they directly relate to one another.*
- ✓ *The focus must include whether the insurance of the manufacturer provides product liability insurance protection; whether there are any exclusions under the policy precluding coverage for a claim or lawsuit; and whether the vendor's or additional insured endorsement lists the distributor and the products it is selling.*

3 Ascertain the ability and responsiveness of manufacturers and their respective insurers to provide defense and indemnification for the sale of their products.

- ✓ *The key inquiries here are centered on whether the distributor:*
 - (a) is fully protected by the manufacturer under the terms and conditions of both the contract and the insurance policies;
 - (b) can fully rely on availability and collectability of the insurance being afforded; and
 - (c) is undertaking any other activities causing liabilities outside of the contract or insurance policy.

4 Deal only with trusted suppliers and manufacturers whose backgrounds, integrity, and veracity have been fully vetted.

- ✓ *Request the names of other distributors and check the manufacturer's past performance with them—not just at the inception of the relationship, but throughout the contract period, as what happens with one customer may be a precursor to what may be coming in the future.*

- ✓ *Undertake an Internet search (using tools like the Google search engine) of the manufacturer and its insurer, and have a Lexis/Nexus or Westlaw search performed to ascertain whether any past or existing lawsuits may have been filed and what the outcome of those suits may have been.*

5 Examine the financial security of the insurance company (both the distributor's and the manufacturer's).

- ✓ *See Number 3, above.*

- ✓ *The distributor's risk manager can best perform this analysis into the financial performance and present status of the manufacturer and its insurance company.*

- ✓ *If a publicly traded company, check the Securities and Exchange Commission (SEC) 10-K reports and annual reports and, if not, ask for a copy of the manufacturer's balance sheet.*

- ✓ *For the insurance companies involved, ascertain the AM Best rating to ascertain the insurer's surplus and financial responsiveness.*

- ✓ *Perform a Google search of the hometown newspaper of the manufacturer/supplier and then search any past articles.*

6 Monitor the NAED Website (www.naed.org) regularly for updates on this topic.

- ✓ *Bookmark the NAED Website and each time you receive a copy of the monthly TED magazine, check the "Liability Project" link for news, information, and additional details on events taking place in the channel.*

7 Establish a disaster recovery and business continuity plan implemented in the event of any state, federal, or other investigation, lawsuit, or claim related to an incident involving a product or component part sold.

- ✓ *The best time to design and implement a response plan is before a loss has occurred.*

- ✓ *Retain the services of a professional disaster recovery and business continuity specialist to work in conjunction with the risk manager and senior management to develop and train on a comprehensive initiative to keep the company running even when a product-related claim, lawsuit, recall, or other unexpected circumstance (e.g., fire, flood, weather event, strike, etc.) arises.*

- ✓ *Involve all departments within the company that will be affected.*

- ✓ *Draft sample news releases and bullet points on the company's background and its activities to be used when needed.*

- ✓ *Determine who the spokesperson of the company will be.*

- ✓ *Examine and update the response plan on an annual basis.*

8 Examine all value-added activities and the content of all training programs and sales literature provided to customers to avoid unintended express or implied warranties.

- ✓ *The risk manager, general counsel, or outside attorney can provide the best advice as to whether and, if so, to what extent, the actions or materials produce potential liability exposure.*
- ✓ *Appropriate language on any contractual undertakings with customers must include the limitations of the activity, and that they are not being offered as guarantees of the customer's independent actions—or inactions.*
- ✓ *If no express or implied warranties are intended by the distributor of products sold over and above those offered by the manufacturer, the face of any sales and training literature, catalogs, etc., must clearly and distinctly explain the limitations.*

9 Examine the necessity and process of any relabeling or alteration of products sold.

- ✓ *Have the sales department work with risk management to eliminate the insurance policy's exclusion of coverage if such action is being undertaken.*
- ✓ *Examine whether relabeling, repackaging, or alteration of the product(s) is necessary.*
- ✓ *Obtain the manufacturer's consent and written agreement to extend its indemnification, defense, and hold harmless protections to these activities as warranted.*
- ✓ *Evaluate the procedures and training of the employees undertaking these tasks to ensure that they are doing so properly and without creating unwanted exposures.*

10 Fully cooperate with all insurers in the event of an incident by placing all potential carriers on notice of the loss immediately, cooperate with all counsel as they become involved, develop an outcome management strategy NOW for matters before they arise, and when they do, establish a budget and timeline to track and measure performance.

- ✓ *The insurance broker and risk manager of the distributor are best situated to liaise with the insurers and attorneys in the event of a loss.*
- ✓ *Be certain to provide a comprehensive report to the insurers as to the background facts and circumstances of the loss, and include any photographs, witness statements, cause and origin reports, suit papers, etc.*
- ✓ *Once a budget and outcome management plan have been agreed upon, a regular evaluation must be performed to ensure that the strategy and resources deployed are on track and producing results.*

The “new realities” are upon us, but the educated and prepared electrical distributor will be successful in ensuring that its brand, relationships, reputation, and balance sheets are well prepared for any outside inquiries and insulated from attack. The risks are great, but the chances of being caught unprepared or unprotected are even greater. However, training, knowledge sharing, and educational initiatives like this and the ongoing, collaborative efforts of industry members will allow electrical distributors and manufacturing professionals to advance forward with strength of conviction. They will be well equipped to address the challenges of the marketplace and distinguish themselves as complements to the trusted reputations their business operations have earned and will enhance for years to come.

¹Friedman, Thomas L., *The World Is Flat: A Brief History of the Twenty-first Century*, Farrar, Straus, and Giroux, 2005.

²Isenstein, Herm, "2007 Economic Update," *Electrical Wholesaling Magazine*, July 2007.

³Id.

⁴"The Power of Private Label: A Review of Growth Trends Around the World," AC Nielsen Global Services, 2005. Further, a large percentage of do-it-yourself hardware retailers report that private label products are beginning to generate more than 25% of store sales. These products include electrical, plumbing, and heating products, as well as power and hand tools, home security systems, and other sundries. *See further*, Wright, Scott H., "The Role of Private Label: Where Does It Fit in Your National Brand Program?" *Do-It-Yourself Retailing Magazine*, March 1997.

⁵Lucy, Jim, "Your Brand Versus My Brand," *Electrical Wholesaling Magazine*, October 2006.

⁶Id.

⁷Zamiska, Nicholas, and Casey, Nicholas, "Owner of Chinese Toy Factory Kills Himself," *The Wall Street Journal*, Aug. 14, 2007, pg. A2.

⁸Fein, Adam J., "Facing the Forces of Change: Lead the Way in the Supply Chain," *National Association of Wholesaler-Distributors and the NAW Institute for Distribution Excellence*, 2007, pg. 20.

⁹Preeg, Ernest H., "The Chinese Export Juggernaut and Manufacturers Overtakes the United States and the Policy Implications," *Manufacturers Alliance/MAPI Economic Report*, March 21, 2006.

¹⁰Id. at pg. 21

¹¹U.S. Consumer Protection Commission – 2000 Annual Report. Our research was unable to discover reliable data on the amount of commercial electrical products that have been involved in claims and lawsuits.

¹²*NFPA Fact Sheet: "Electrical Fires in the Home,"* 2006. Further, according to data collected from fire departments across the country, electrical distribution and lighting products are a leading cause of fires in homes. On a year-to-year average, electrical distribution or lighting equipment causes 13,100 of all structure fires in homes, resulting in 140 civilian deaths, 580 civilian injuries, and \$340 million in property damage. These data are provided by the National Fire Protection Association and other sources through the National Fire Incident Reporting System (NFIRS). *See also*, Sreejith, P.G., *Cholamandalam AXA Risk Services, Ltd.* "Global Developments in Electrical Safety," presented before the *Electrical Safety Week Congress*, June 13, 2003, Perambur, India (25% of all fires in the United States are caused by electricity; 411 job-related electrical accidents occur annually; electrocution is the fifth leading cause of death [citing to NIOSH]).

¹³Id.

¹⁴Id.

¹⁵*USA Today*, Aug. 14, 2007, quoting the U.S. Census Bureau, pg. A-1.

¹⁶*Black's Law Dictionary*, 6th Edition, 1991.

¹⁷Id.

¹⁸*See also*, Baldwin, Hare, and McGovern, *The Preparation of a Product Liability Case*, Little Brown and Company, 1993, Second Edition.

¹⁹The law allows an injured party to seek redress for the amount of medical bills incurred whether or not covered by a health insurance company, which, if applicable, may have a lien against any of the proceeds recovered, but also including loss of work, negligent infliction of emotional distress, loss of consortium, and other damages.

²⁰Some jurisdictions, like the United Kingdom, have authoritative texts, on which the courts, barristers, and solicitors rely in establishing demands for the value of injuries and losses sustained.

²¹In the federal circumstances, the venue statute is 28 U.S.C.A. § 1391. State venue rules are based upon individual state statutes.

²²Consumer Protection Act, Section 2, 1987.

²³Presser, Stephen, "How Should the Law of Products Liability be Harmonized? What Americans Can Learn from Europeans," *Manhattan Institute for Policy Research: Global Liability Issues*, Volume 2, February 2002.

²⁴Clayton Utz, *Product Liability Asia-Pacific Survey*, 2007.

²⁵Kellam, Jocelyn, "A Little Bit Pregnant? Product Liability in the Asia Pacific," *For the Defense*, Defense Research Institute, January 2007, pg. 12-17. *See also* the "International Comparative Legal Guide to Product Liability: A Practical Insight to Cross-Border Product Liability Work," *Global Legal Group*, 2005.

²⁶*See further*, the discussion on joint and several liability below.

²⁷Under the current state of the law, parties injured by a product defect are usually only liable when they have assumed the risk of a known danger related to the product or misused the product from its intended purpose. However, the concept of attributing some comparative fault against an injured party in limited circumstances is making a resurgence in the writings of various legal scholars.

²⁸*See further*, Silcox, Clark R., and Colburn, Philmore H., "Counterfeit Products Present Additional Business Risks for Distributors and Contractors," *International Association of Electrical Inspectors Magazine*, May/June 2005; and Silcox, Clark R., "Not Just Dangerous to Health and Safety...but Dangerous to Your Business Health as well," *National Electrical Manufacturers Association*, 2006.

²⁹Mew, Joseph, "Targeting Unsafe Products," *Electrical Line Magazine*, July/August 2006.

³⁰Id.

³¹Chandler, Doug, "An Increase in Production of Counterfeit Electrical Products over the Past Decade Puts the Industry's Supply Chain at Risk," *Electrical Wholesaling Magazine*, April 1, 2007.

³²For further information on the steps that can be taken to protect a business or commercial/private consumers from counterfeit or pirated electrical products, see *Appendix D*.

³³*See further*, Monks, Brian H., "Electrical Connections: How Can I Tell if a UL Listing Mark Is Counterfeit," *The Authority Magazine-Underwriters Laboratories, Inc.*, November 2005; and Mayberry, Ann, "Counterfeit Electrical Products Pose Major Safety Hazards!" *Electrical Safety Foundation International*, Sept. 29, 2005.

³⁴*See further*, "Secure Supply Chain Best Practices Tool Kit: Protecting Businesses, Consumers and Brand Integrity," *Coalition Against Counterfeiting and Piracy (CACAP)*, 2006.

³⁵deRuvo, Pierre, IECCE Executive Secretary, "Consumer Products: Counterfeit Problems and Anti-Dumping Measures," *Worldwide System for Conformity Testing and Certification of Electrical Equipment (IECEE)*, presented at the Berlin Congress Workshop, 2006.

³⁶Estey, John, National Electrical Manufacturers Association, "Sharks in the Water," *Transmission and Distribution World Magazine*, May 1, 2007.

³⁷Id.

³⁸"Counterfeit Electrical Equipment Is Hazard to Life and Property," *Arabian Anti-Piracy Alliance*, Dubai, United Arab Emirates, Jan. 19, 2003.

³⁹U.S. Consumer Products Safety Commission 2006 Annual Report and 2007 Performance Budget (Operating Plan), February 2007.

⁴⁰Id.

⁴¹In the event an electrical distributor becomes aware of a dangerous product or a product-related injury, the CPSC hotline number to report the incident is 800-638-2772.

⁴²The Lanham (Trademark) Act (15 USC § 22 of the United States Code) is a federal law containing the statutes of trademark law in the United States. The Act prohibits a number of activities, including trademark infringement, trademark dilution, and false advertising.

⁴³ISO Properties 2000; *see also* ISO Form CG 00 01 12 04 for identical language relating to the coverage grant noted and the operative exclusion and definitions.

⁴⁴Product liability insurance indemnifies the insured against all sums that the insured becomes legally liable to pay in respect of accidental bodily injury or illness to third parties, and accidental loss of or damage to third-party property, arising out of the defect, malfunction, use, misuse, or handling of products or goods manufactured or sold.

⁴⁵Excess liability insurance is placed over a specific liability insurance policy already in place and increases the per person and per accident or per occurrence limits of liability in that particular policy. It incorporates all the provisions of the specific underlying policy, such as its insuring agreements, definitions, exclusions, and limitations (or “follows form” with the underlying policy), but does not have any effect on any other liability insurance policies that the insured manufacturer or distributor may have.

Umbrella liability insurance, in contrast, is placed over most major policies in a company’s liability insurance program, to increase the limits of liability in each of the liability policies in that organization’s program that are enumerated and scheduled to the umbrella policy. And, it often offers broader coverage, with few exclusions or limitations and more liberal definitions than the underlying liability policies in the organization’s program. The umbrella policy will also traditionally “drop down” to provide first-dollar liability coverage (above any “self-insured retention” or other deductible) in many (but not all) areas of potential liability for which the manufacturer or electrical distributor has no other, more specific, liability coverage.

See further, Malecki, Donald S. “Excess versus Umbrella Liability: Understanding the Differences,” *Rough Notes Magazine*, September 2001.

⁴⁶There are essentially three types of coverage available that relate to product recall claims: (1) product recall; (2) malicious tampering/accidental contamination; and (3) product liability. Any one of these can be a stand-alone policy or an added endorsement to a company’s property policy. A product recall policy, standing alone, covers the logistical costs of a recall, such as publicity, transportation and storage of the item, repairing and returning the item, and other extra expenses necessary to carry out the recall. This type of policy will not cover the costs of lost profits and rehabilitating a product’s public image, although special endorsements may be available to include lost profits coverage. *See further*, Torpey, Daniel T., “Are You Ready for Total Recall? A Guide to Product Recalls and the Insurance That Covers Them,” *Insurance Risk Management Institute*, Expert Commentary, November 2000.

⁴⁷A common form used for this purpose is the ACORD 25 (2001/08) certificate.

⁴⁸*Id.*

⁴⁹*See further*, the discussion above and remember the certificate of liability insurance is merely “evidence of insurance” and not documentary proof of insurance coverage one would seek to use to enforce the provisions of the insurance contract to hold harmless, defend, and indemnify against the manufacturer or supplier in favor of protecting the distributor from a claim or lawsuit.

⁵⁰*See further*, below.

⁵¹For publicly traded distributors, this circumstance may have an additional exposure. A claim could be asserted by stockholders that the directors and officers of the corporation knew or should have known of this prospect and failed to take measures to guard against it, and that this failure has resulted in the stock value, reputation, and goodwill of the enterprise to be diminished.

⁵²Another option is for the distributor to be named as an “additional named insured” to the manufacturer’s insurance policy. This provides the additional named insured with the same status and rights (e.g., being advised in the event of cancellation or nonrenewal of the insurance policy) and responsibilities (save for the payment of premium) as the named insured manufacturer. This concept is rarely used as it would extend the rights of the distributor in the insurance policy beyond the relationship with the manufacturer for the specific products being sold. However, the law in the field is evolving, to the extent that such arrangements can be better represented by manuscript wording of an endorsement affording greater protection to the electrical distributor.

⁵³The term “deductible” refers to a designated sum that is subtracted from the insurer’s indemnity and/or defense obligation under the policy. The insurer’s obligation does not ripen until the deductible is met by the insured. *Int’l Bankers Ins. Co. v. Arnone*, 552 So. 2d 908 (Fla. 1989). The declarations page of the policy typically states the amount of the deductible, although a variety of endorsements can be used. A “self-insured retention,” or SIR, is similar to a deductible because it represents a dollar amount of retention by the party being insured such as the manufacturer. The amount of the “retention” is not covered by insurance. An SIR applies not only to judgments or settlements, but also to defense costs and expenses. The insured must exhaust the SIR before the insurance company will respond to the loss. Most significantly, the insured with an SIR usually assumes responsibility for claims handling within the amount of the retention and will report to the insurer only those claims likely to exceed the retained limit. By contrast, deductibles are tendered to the insurer, and the insurer provides for the defense of its insured. Moreover, with deductibles, the insurer typically pays the amount of any judgment or settlement and then bills the insured for the deductible.

⁵⁴Most domestic manufacturers who have commercial general liability insurance policies use an ISO form CG 20 15 for this purpose.

See further, below.

⁵⁵The industry also permits the use of “blanket” vendor’s endorsements which do not specify the name of the distributor(s) or product(s) and provide protection to all vendors of the manufacturer.

⁵⁶ISO Form CG 20 15 11 88. *But, see*, ISO’s amended Additional Insured – Vendors CG 20 15 endorsement, which became effective July 2004 in most jurisdictions. While the provisions are substantially similar to the CG 20 15 11 88 form detailed above (requiring the vendor and products sold to be specifically enumerated), the exclusions to coverage of the CG 20 15 07 04 form add an exclusion for bodily injury or property damage arising from the sole negligence of the vendor. Therefore, any of the distributor’s own acts, omissions, those of its employees or anyone acting on the distributor’s behalf will not allow coverage to be afforded – except for the following: unpacking solely for the purpose of inspection, demonstration and testing; and demonstration, installation, servicing, or repair operations performed at the vendor’s premises in connection with the sale of the product only.



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